UNJUST ENRICHMENT AND THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS

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ABSTRACT

Professor Douglas G. Baird's book, The Unwritten Law of Corporate Reorganizations, provides a masterclass on the fundamental principles that animate the world of corporate reorganizations. Professor Baird shows that the unwritten law of corporate reorganizations facilitates transparent and fair bargaining among sophisticated actors over a distressed firm's future. Though fraud and deception are verboten, so is judicial favoritism. Since all parties are sophisticated actors, it is inappropriate for judges to favor particular parties and meddle in the reorganization.

Though Professor Baird draws the unwritten law from fraudulent conveyance law, fraudulent conveyance law does not show why the unwritten law addresses the concerns unique to corporate reorganizations. In this Book Review, I argue that the unwritten law of corporate reorganizations is a form of unjust enrichment jurisprudence, which is the area of law that addresses nonconsensual transfers of benefits from one party to another. Viewing the unwritten law through this lens has two benefits. First, unjust enrichment principles connect the need for corporate reorganizations with the unwritten law. Second, tying the unwritten law to unjust enrichment illuminates how to tailor the unwritten law when those reorganizations depart from the unwritten law's fundamental assumptions. Mass tort cases are a prime example because they feature involuntary, unsophisticated parties. Unjust enrichment principles provide justification for modifying the unwritten law to ensure a fair bargaining environment among the parties.

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1 DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS (2022).

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INTRODUCTION

For an area of law governed by Title 11 of the United States Code, the rules governing corporate reorganizations are mostly off the books—or so argues Professor Douglas Baird in his latest book.1 While the Bankruptcy Code has an important role to play in the world of corporate reorganizations, understanding that world requires one to learn the norms of the trade that are orthogonal to, and long predate, the Bankruptcy Code. These norms dovetail towards the goal of giving the parties—all of them sophisticated—the breathing room necessary to reach a deal that at least most of them can live with.

The bankruptcy judge overseeing the corporate reorganization arranges, and thereafter polices, the space in which negotiations are to be held. On Professor Baird's account, this is a tall order. Picking winners and losers smothers negotiations and prevents the debtor's assets from being put to their highest and best use. But by the same token, the bankruptcy judge must compel the parties to fairly negotiate with one another. So long as everyone has a seat at the table—and no money is passed under the table—the judge must allow the bargaining process to play out however it does.

Professor Baird derives the unwritten law from fraudulent conveyance law, but doing so does not explain how the unwritten law relates to the need for corporate reorganizations in the first place. Fraudulent conveyance law applies to all debtor-creditor relations, whether the debtors and creditors are in chapter 11 proceedings or not. While certainly important, fraudulent conveyance principles do not link corporate reorganizations as such with the unwritten law that Professor Baird charts.

In this Book Review, I argue that the unwritten law of corporate reorganizations embodies unjust enrichment principles, which govern benefits that one party nonconsensually transferred to another party. . By forcing a recipient to return what it wrongfully obtained from a claimant, unjust enrichment helps reduce otherwise skyrocketing monitoring costs. This relief is limited; a claimant cannot recover a consensual transfer of a benefit to a recipient. Unjust enrichment principles channel the parties to bargain over their entitlements' ex ante. These themes emerge in the literature on why we need a law of corporate reorganizations at all. High transaction costs prevent the parties from addressing their entitlements when the firm becomes financially distressed, and the parties must consequently bargain their entitlements ex post. This tense environment may incentivize parties to abscond with value that would otherwise maximize the value of the estate, resulting in increased monitoring costs. Bankruptcy judges, in turn, are charged with tamping down on that kind of value-squandering behavior. So understood, unjust enrichment principles bridge the unwritten law with the purpose of having the law of corporate reorganizations—written or unwritten—in the first place.

Tying the unwritten law to unjust enrichment yields other benefits as well. Professor Baird is careful to limit his prescriptive analysis to cases where sophisticated parties engage in the rough and tumble of corporate reorganizations. As early as the 1980s, however, bankruptcy courts served as forums for corporate entities to resolve bundles of tort claims. Under those circumstances, unsophisticated, involuntary creditors must face a corporate debtor at the bargaining table. Principles of unjust enrichment provide a framework for modifying the unwritten rules of corporate reorganizations to protect tort victims so that they may bargain on a more equal footing with mass tort debtors.

Part I of this Book Review briefly summarizes Professor Baird's account of the unwritten law, with particular focus on how bankruptcy judges should handle complex corporate reorganizations. Part II briefly sketches the principles of unjust enrichment, and Part III shows how these principles animate the unwritten law of corporate reorganizations. Part IV illustrates how principles of unjust enrichment call for modifying the unwritten law to address mass tort bankruptcies.

I: FACILITATING CORPORATE REORGANIZATIONS

Unlike some other histories of American bankruptcy law, *The Unwritten Law of Corporate Reorganizations* tells the story of how the basic norms of corporate reorganizations developed.[2] The genesis of these norms is the Statute of 13 Elizabeth, first passed in 1571, which prohibited a debtor from engaging in fraudulent transfers designed to "hinder, delay, or defraud" the debtor's creditors.[3] While the Statute of 13 Elizabeth spoke in terms of a debtor's intent, courts quickly expanded the Statute's reach to include transactions that featured so-called "badges of fraud."[4] They warned that "badges could take many forms" and "indicia that a transaction was not an arm's-length deal in the marketplace" were especially alarming.[5] If a court spotted a sufficient number of those indicia, it would void the underlying transaction.[6]

By the middle of the 19th century, railroads sprawled across the United States, enabled by magnates with increased access to capital markets.[7] Managers utilized several debt and equity instruments to finance these firms, leading to ever-more complex capital structures.[8] Serpentine capital structures also begot the opportunity for parties to opportunistically capture value at the expense of other investors in the firm, especially when a railroad's fortunes soured.

Courts therefore voided transactions that were consummated to undermine some of the creditors' rights, even if one or more other creditors benefited from

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2 *See generally* DAVID A. SKEEL JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2003).

3 BAIRD, *supra* note 1, at 11 (quoting 13 Eliz., ch. 5 (1571)).

4 *Ibid.*

5 *Ibid.*

6 *Id.* at 11-12.

7 *Id.* at 22-24.

8 *Ibid.*

these transactions.[9] In one such case, senior creditors of an insolvent railroad sought to sell the railroad's assets to a third party despite opposition from the railroad's old equity holders. The senior creditors and the equity holders eventually agreed to sell the assets and split the proceeds, freezing out the railroad's junior creditors.[10] The United States Supreme Court unwound the transaction on the grounds that the equity holders were not entitled to any proceeds from the sale so long as the junior creditors' debts went unpaid.[11] As Professor Baird explains, "[l]eakage of value to shareholders when a corporation is wrapping up is a badge of fraud."[12]

With the advent of equity receiverships in the late 19th century, courts had to apply the Statute of 13 Elizabeth and its progeny to cases where parties sought to reorganize, as opposed to wind down, a firm's business.[13] Everyone agreed that courts should void reorganizations featuring badges of fraud, let alone outright fraud. The central question was how much a court should involve itself in reorganizations.[14] Courts soon held that judges overseeing equity receiverships cannot stand idly while the parties negotiated.[15] Judges must supervise the proceedings, so the parties negotiate fairly among themselves and do not exclude from the negotiations any segment of investors from the capital structure.[16] In *Northern Pacific Railway Co. v. Boyd*, for instance, the Supreme Court held that a distressed corporation's shareholders had to make a "fair offer" to unsecured creditors who might otherwise be frozen out of the newly reorganized corporation.[17]

Nevertheless, Professor Baird persuasively shows that when judicial oversight is concerned, there can be too much of a good thing. New Deal reformers, such as William O. Douglas and Jerome Frank, believed judges should intervene to ensure that "worthy debtors" would successfully reorganize.[18] So too did Douglas believe that when an investor participates in a corporate reorganization, they can only bring their interest in the corporation to the bargaining table; the investor could not advance other interests that they may have outside of the

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9 *Id.* at 14-17.
10 Chicago, Rock Island & Pac. R.R. Co. v. Howard, 74 U.S. (7 Wall.) 392, 407-09 (1868).
11 *Id.* at 409-10, 413.
12 BAIRD, *supra* note 2, at 18.
13 *Id.* at 29.
14 *Id.* at 29-30.
15 *Id.* at 39.
16 *Id.* at 42-44.
17 Northern Pac. Ry. Co. v. Boyd 228 U.S. 482, 508 (1913). *See also* BAIRD, *supra* note 1, at 43 ("After *Boyd*, it became clear that …. [a] judge supervising a reorganization had an affirmative obligation to ensure that everyone had a fair opportunity to participate in the process."). For a brief explanation of the bargaining dynamics in corporate reorganizations before and after *Boyd*, see SKEEL, *supra* note 2, at 67-68.
18 BAIRD, *supra* note 1, at 78, 108.

corporation[19] Douglas got his way when Congress passed Chapter X, the predecessor to the modern Chapter 11, which gave the trustee the authority to form a plan of reorganization for the distressed firm and[20] Congress and the corporate reorganizations world eventually concluded that Chapter X was unworkable, and Congress heavily modified[21]

The problem with Douglas's outlook, according to Professor Baird, is that it assumes that judges know far more about the bargaining dynamics that underlie corporate reorganizations than they actually do. What is more, it is difficult to discern when a debtor is "worthy" or when a party is advancing its interests outside of the reorganizing corporation. A judge can easily falter when making these judgments using highly imperfect information.[22] Heavy judicial thumbs on scales can lead to distorted, costly, and failed corporate reorganizations.[23]

For Professor Baird, the right approach to shepherding corporate reorganizations starts with a few simple truths. Bankruptcy judges have limited information before them—information that a party likely curated to induce the judge to rule in that party's favor.[24] It is also essential that "the rules of corporate reorganization, whether written or unwritten, allow parties to negotiate with one another once the reorganization begins."[25] A hygienic bargaining environment is one in which all the relevant parties are brought to the table and neither of them have stacked the cards against the others by engaging inside deals, fraud, or deception.[26] With chicanery sufficiently policed, "[r]eorganization law depends crucially upon the parties themselves finding common ground."[27]

These axioms lead Professor Baird to conclude that the judge's role in corporate reorganizations is to allow the parties to negotiate under fair and transparent rules.[28] This requires the judge to do neither too much nor too little. Picking winners and losers is verboten[29]And yet:

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19 *Id.* at 81-82, 90.
20 *Id.* at 105, 108.
21 *Id.* at 107, 130-40.
22 *Id.* at 81-82, 118.
23 *See id.* at 82, 88-89, 112.
24 *Id.* at 141.
25 *Id.* at 129.
26 *Id.* at 139.
27 *Id.* at 128. Though Professor Baird does not say as much explicitly, the norms that he discusses seemingly apply only to large corporate reorganizations, which are likely to feature countless creditors and complex capital structures. These features are likely absent in small business cases, where creditors will tend to be landlords and trade creditors. *See* DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 211-14 (6th ed. 2014). Indeed, Congress adopted a streamlined version of Chapter 11, known as Subchapter V, specifically designed for small business reorganizations. *See* 11 U.S.C. §§ 1181 – 1195; *id.* § 1182(1) (defining "debtor" for Subchapter V purposes as an entity with not more than $7,500,000 in total business-related debt).
28 BAIRD, *supra* note 1, at 161-62.
29 *Ibid.*; *id.* at 165.

Sometimes judges must prove they will walk away from what appear to be value-maximizing transactions in order to deter strategic behavior. A judge who gives in to destructive behavior invites such behavior in future cases. The judge must also take account of the difficulties in determining whether the transaction is in fact aboveboard and wealth-enhancing. Payments to insiders and strategic players are always troublesome. The more ties the estate has with a party, the more likely it is that the deal is not what it appears to be. And the more exotic the transaction, the less likely it is that the bankruptcy judge can completely understand what is going on.[30]

For Professor Baird, bankruptcy judges are like referees. They must ensure the parties adhere to the rules of the corporate reorganization game once the rules are set.[31] To be sure, self-dealing, bribery, and fraud must be quashed, yet rarely are those evils so neatly labeled. Restructuring support agreements and "side payments", for example, can be valid tactics to grease the machinery in Chapter 11 cases or rather suspicious side deals.[32] Bankruptcy judges should therefore order the parties to disclose information to the extent that the benefits of doing so outweighs the costs.[33]

Finally, judges should approach their cases pragmatically. The Bankruptcy Code sets some of the rules of corporate reorganizations, but strict adherence to the Bankruptcy Code bogs down negotiations and mires corporate reorganizations.[34] Unless there is simply no way around it, the Code should not stand in the way of the parties reaching a deal in which most of them will be better off.

Professor Baird justifies the use of these unwritten rules, in large part because large corporate reorganizations feature sophisticated parties who can adequately price for risk, and, in many instances, who specialize in handling distressed debt situations.[35] Even when both sophisticated and unsophisticated creditors are in the mix, sophisticated creditors will make sure to take care of the unsophisticated ones. In Marvel Entertainment's corporate reorganization, for instance, many creditors were comic book fans with outstanding subscriptions. It made sense to respect these fans' subscriptions without batting an eye; that was just good [36] So the unwritten rules that Professor Baird identifies and champions apply under the assumption that sophisticated actors—and only sophisticated

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30 *Id.* at 155.

31 *Id.* at 143.

32 *Id.* at 142, 146-48, 172-78.

33 *Id.* at 142.

34 *See id.* at 173-75. Of course, one may raise numerous concerns about this lax attitude towards the Code. *See, e.g.*, Vincent S.J. Buccola, Book Review, *Unwritten Law and the Odd Ones Out*, 131 YALE L.J. 1559, 1579-82 (2022) (identifying "rule-of-law as well as economic reasons" to question judges' disregard of the Bankruptcy Code in favor of unwritten corporate reorganization rules).

35 BAIRD, *supra* note 1, at 118-19, 126-27.

36 *Id.* at 166-67.

actors—know about, and are prepared for, the rough and tumble of modern corporate reorganization practice.

Professor Baird's account shows how the unwritten rules of corporate reorganizations stem from fraudulent conveyance principles and blossomed into the flexible yet defined principles that judges and practitioners abide by today. Insightful as Professor Baird's account is, drawing the unwritten rules from fraudulent conveyance principles is curious. For one thing, as Professor Thomas H. Jackson, Professor Baird's longtime collaborator, notes, "[a]lthough fraudulent conveyance law is generally necessary only if a debtor becomes insolvent, that does not mean that it is essentially related to the justification for a bankruptcy process."[37] Fraudulent conveyance principles are tailored to unwind transactions in which the debtor actually intended to hinder, delay, or defraud its creditors, or those transactions that could almost never benefit creditors and therefore creditors would never agree to.[38] As such, fraudulent conveyance principles have historically applied to a wide array of transactions and other mechanisms for addressing debtor-creditor tensions, such as assignments for the benefit of creditors.[39]

This point leads to another, more fundamental, concern: the fraudulent conveyance principles that the unwritten law is drawn from cannot explain why we need corporate reorganizations at all. Fraudulent conveyance principles deal with broader debtor-creditor concerns, not corporate reorganizations in particular. The concerns that animate fraudulent conveyance law will arise whether or not the debtor has filed for bankruptcy. In all cases implicating fraudulent conveyances, the judge—whether supervising a bankruptcy or some other proceeding—will have to examine suspicious transactions closely, not pick winners and losers based on loose intuitions about fairness, and so on. Tying the unwritten law to fraudulent conveyance law sheds little light on why the unwritten law is the unwritten law of corporate reorganizations, and not, say, the unwritten law of commercial transactions.

This is not merely a concern about conceptual housekeeping (important as that task may be). Corporate reorganizations are extremely powerful tools, unparalleled in the federal and state arsenals, that companies can use to help manage their episodes of severe financial distress. If the unwritten law, as Professor Baird has outlined it, is the unwritten law of *corporate reorganizations*, a stronger thread needs to be woven between the purpose of having corporate reorganizations and how the unwritten law helps facilitate or accomplish that purpose.

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[37] THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 147 (Beard Books, 2001).

[38] *See* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VANDERBILT L. REV. 829, 832 (1985), https://scholarship.law.vanderbilt.edu/cgi /viewcontent.cgi?article=2752&context=vlr

[39] *See, e.g.*, John Waters v. Samuel Comly, 3 Del. (3 Harr.) 117, 134 (Del. Ct. E. & A. 1840) (explaining that a debtor's assignment of property for the benefit of only some of its creditors is considered fraudulent under Delaware law).

This is not to say that drawing the unwritten law from fraudulent conveyance principles is wrong as a historical matter. As a species of debtor-creditor relationships, it makes sense that corporate reorganizations and the norms that govern them would have some connection to the Statute of 13 Elizabeth and the fraudulent conveyance principles that emanated from it. But the historical origins of a particular doctrine or practice can mask the underlying policy goals that the doctrine or practice was designed to advance.[40] The concern here is that fraudulent conveyance principles alone cannot explain the link between why we need corporate reorganizations and how the unwritten law helps facilitate corporate reorganizations in light of this purpose. So even the unwritten law historically originates from fraudulent conveyance principles, another framework is needed in order to link the purpose of having corporate reorganizations with the unwritten law.

I think that the law of unjust enrichment provides a promising framework that connects the unwritten law with the purpose of corporate reorganizations. To see how, we first need a primer on what unjust enrichment is. That is what the next section will provide.

II: A BRIEF SKETCH OF UNJUST ENRICHMENT

Unjust enrichment is the domain of private law that addresses how parties must allocate benefits that they did not previously allocate among themselves. Though only recognized as a distinct area of private law after the publication of the *Restatement of Restitution* in 1936, principles of unjust enrichment can be traced back to Roman law.[41]

Readers should not confuse unjust enrichment, which is a cause of action, with a set of remedies gathered under the header of "restitution." Unjust enrichment is a cause of action for when a recipient wrongfully obtained benefits from a nonconsensual transaction with a claimant.[42] Depending on the facts of the case, a prevailing plaintiff may choose from numerous remedies such as obtaining the

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[40] Professor David Skeel has shown as much with respect to the classic mantra that there must be equality among creditors in bankruptcy proceedings. As he persuasively argues, equality among creditors was a heuristic designed not to ensure equality among creditors as such, but rather to quash opportunities for self-dealing or other value-capturing behavior. *See* David A. Skeel, Jr., *The Empty Idea of "Equality of Creditors"*, 166 U. PA. L. REV. 699, 702-03 (2017), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=2726&context=faculty_scholarship

[41] *See* Andrew Kull, *Rationalizing Restitution*, 83 CAL. L. REV. 1191, 1192 (1995); *The Intellectual History of Unjust Enrichment*, 133 HARV. L. REV. 2077 (2020).

[42] *See* RESTATEMENT (THIRD) OF UNJUST ENRICHMENT § 1 cmts. b & c; § 3 (AM. LAW INST. 2011) (hereinafter "RESTATEMENT"); Kull, *supra* note 41, at 1212-22; WARD FARNSWORTH, RESTITUTION: CIVIL LIABILITY FOR UNJUST ENRICHMENT 11-13 (2014).

defendant's monetary gains, rescinding a contract, imposing a constructive trust or an equitable lien, and [43]

Though unjust enrichment may be unfamiliar to some, it operates in the shadow of contract law, much in the way tort law does.[44] Tort law, as it were, is the law of "non-bargained for" harms. As such, it addresses how parties should bear the costs of those harms, as well as the precautions designed to prevent them. Had the parties negotiated how they would allocate the costs of bearing those harms and precautions, there would be little role for tort law to play.[45]

The same line of thought applies to unjust enrichment as the law of "non-bargained for" benefits. If parties can contractually stipulate how they will bestow benefits onto each other or allocate benefits that they jointly create, unjust enrichment has no role to play.[46] This is why a claimant who gives an unrequested benefit to a recipient cannot later prevail on a claim for unjust enrichment.[47] Absent dire circumstances (i.e., circumstances in which transaction costs are too high for bargaining to take place between the parties), if a party wishes to give value to another party in exchange for some kind of consideration, it is on the value-giving party to make that proposal explicit. Foisting benefits onto others in hopes of receiving compensation later makes little sense when the parties can contractually set their rights and responsibilities.[48]

The law of unjust enrichment comes into play when transaction costs prevent the parties from writing "obligationally complete" contracts,[49] or when a party intentionally captures benefits that it had no right to capture.[50] In each of those cases, benefits flow from one party to another "non-consensually," making

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43 RESTATEMENT § 49, 54-58.

44 *Id.* § 1 cmt. d.

45 *See* Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 2-15 (1960).

46 *See* WARD FARNSWORTH, RESTITUTION: CIVIL LIABILITY FOR UNJUST ENRICHMENT 14-17 (2014).

47 *See* RESTATEMENT § 2(3), cmt. d.

48 *See* FARNSWORTH, *supra* note 46, at 10; Hanoch Dagan, *Restitution in Bankruptcy: Why All Involuntary Creditors Should Be Preferred*, 78 AM. BANKR. L.J. 247, 272 (2004) (arguing that the involuntariness of a transfer stands at the heart of unjust enrichment).

49 *See* Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 730 (1992) https://openyls.law.yale.edu/bitstream/handle/20.500.13051/770/Strategic_Contractual_Inefficiency_and_the_Optimal_Choice_of_Legal_Rules.pdf;jsessionid=A12E8DFD394A53CF0926B96573C4893D?sequence=2 (defining obligationally complete contracts as "fully specified for all future states of the world").

50 This includes, but is not limited to, intentionally tortious conduct. *See* FARNSWORTH, *supra* note 46, at 11 (noting that unjust enrichment helps deter intentionally tortious conduct); WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 153, 160-61 (1987) (defining intentionally tortious conduct as conduct in which "the costs of avoidance to the injurer are low relative to the social benefits of the activity," and arguing that punitive damages may be necessary to increase the injurer's costs of engaging in intentionally tortious conduct to deter such behavior).

those transfers invalid as a matter of law.[51] Scholars identify two main justifications for this broad principle. First, authorizing nonconsensual transfers affronts persons' autonomy interests. Allowing other parties to reap the benefits that were taken from an individual without their consent subjects them to the capricious whims of other people.[52] Second, allowing an enriched defendant to reap the benefits of a nonconsensual transfer is not merely a matter of value sloshing from one party to another. If such a transfer were allowed, parties would take too many precautions to prevent value from leaking to the other parties. This would be a poor use of resources and, in due time, may increase transaction costs for when parties want to possibly bargain their entitlements among themselves.

Take the case of mistaken payments. In the prototypical case, the claimant makes a small error, which subsequently bears significant consequences for herself and enriches the recipient. Suppose, for example, the claimant agreed to purchase the recipient's book for $10, but accidentally "Venmos" the recipient $100. Regardless of whether the proper remedy in this situation would be "restitution," the claimant can likely prevail on a claim for unjust enrichment against the recipient and have the $100 returned to her.[53] Had the recipient been allowed to keep the $100, the claimant would adopt not just any precautions, but overly costly precautions in order to prevent similar mistakes.[54] Sure, some degree of precaution is beneficial; but increasing parties' monitoring costs means devoting resources to establishing onerous precautions when those resources can be used more productively. Unjust enrichment, then, helps reduce the pressure to guard oneself too much against losing value.

The contours of unjust enrichment law suggest that it is designed to provide parties with the incentives to allocate their resources efficiently in light of high transaction costs. In the first instance, parties should try to bargain among themselves as to how they will divide any surplus that they jointly create.[55] When a contract clearly allocates each party's rights and responsibilities, a disgruntled party may not call upon unjust enrichment principles to undercut the bargain.[56] But when high transaction costs prevent the parties from adequately allocating benefits among themselves, the law of unjust enrichment induces parties to invest, but not *overinvest*, in precautions designed to guard value from leaking elsewhere.[57]

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[51] RESTATEMENT § 1 cmt. b.

[52] *See* HANOCH DAGAN, THE LAW AND ETHICS OF RESTITUTION 43 (2004).

[53] *See* RESTATEMENT § 48. *See also* FARNSWORTH, *supra* note 46, at 14-15. This assumes the claimant and recipient did not contractually allocate the risk of making mistaken payments. *See id.* at 17-19.

[54] *See* FARNSWORTH, *supra* note 46, at 11.

[55] *See id.* at 10; RESTATEMENT § 2 cmt. c ("Contract is superior to restitution as a means of regulating voluntary transfers because it eliminates, or minimizes, the fundamental difficulty of valuation.").

[56] *See* RESTATEMENT § 2(2).

[57] *See* FARNSWORTH, *supra* note 46, at 11.

The law of unjust enrichment gives courts flexibility in applying its doctrines. A claimant, for example, can prevail in her claim for unjust enrichment if the recipient was enriched at the claimant's expense and the recipient engaged in "intentional and profitable wrongdoing of which the claimant is recognizably the victim."[58] While this principle may seem hopelessly indeterminate,[59] it reveals that unjust enrichment is an equitable cause of action designed to tamp down on opportunism.[60] Professor Henry Smith defines opportunism as "undesirable behavior that cannot be cost-effectively defined, detected, and deterred by explicit *ex ante* rulemaking," as well as "behavior that is technically legal but is done to secure unintended benefits that are usually smaller than the costs they impose upon others."[61] Responding to costly behavior *ex post* deters mischievous, value-seizing behavior, especially when the enriched recipient could have negotiated with the claimant *ex ante* as to how to apportion those benefits.

In short, unjust enrichment law incentivizes parties to take cost efficient precautions to prevent value from unintentionally leaking elsewhere. Encouraging parties to take too few precautions allows parties to be sloppy with their property, since they can assume that they will be able to claw back secreted value from the recipient. By contrast, encouraging parties to take too many precautions increases monitoring costs, which may in turn stymie efficient allocations of resources going forward. Channeling parties towards taking cost efficient precautions presses parties to be careful with their property while not raising transaction costs too high. It further encourages the parties to set their entitlements by contracting among themselves. When that is not possible, unjust enrichment principles will be used to combat opportunistic, value-capturing behavior.

III: UNJUST ENRICHMENT AS THE SOURCE OF THE UNWRITTEN LAW

To see how corporate reorganizations, unjust enrichment, and the unwritten law hang together, we must start with the purpose of having corporate reorganizations in the first place.

In a world free of transaction costs, parties would be able to anticipate and bargain their entitlements in light of every possible contingency that a firm would

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58 RESTATEMENT § 44 cmt. a.

59 *See* Emily Sherwin, *Restitution and Equity: An Analysis of the Principle of Unjust Enrichment*, 79 TEX. L. REV. 2083, 2106-07 (2001) ("[W]hat makes unjust enrichment both powerful and dangerous when interpreted as a legal principle is its open-endedness.").

60 *See* RESTATEMENT § 4 cmt. b (noting that while "[t]he law of restitution is not easily characterized as legal or equitable," "[i]t is fair to conclude that even the legal side of unjust enrichment had its origin in equitable principles").

61 *See* Henry E. Smith, *Equity as Meta-Law*, 130 YALE L.J. 1050, 1080 (2021), https://docs.google.com/viewerng/viewer?url=https://www.yalelawjournal.org/pdf/Smith_i8qnzgea.pdf.

face, including the possibility of financial distress.[62] This is an incredibly strong claim because financial distress is far from monolithic; distress comes in many different flavors and distressed firms face a wide variety of obstacles.[63] But in a transaction cost-free world, parties would be able to account for and establish their relative rights for each and every one of those scenarios.[64]

Of course, in the real world, skyrocketing transaction costs preclude the parties from making complete contracts.[65] When accounting for how parties address distress in the real world, the key is to look at how non-bankruptcy rights work in tandem with bankruptcy law.[66] A firm's investors will price for the risk of the firm's insolvency when making their investments. For example, a secured creditor charges lower interest rates in exchange for the firm backing the loan with a security interest in the firm's assets.[67]

To the extent that a debtor has not fully performed their end of the bargain with the creditor, the debtor has value to which the creditor has some claim.[68] The problem is, of course, that the debtor has numerous creditors with whom the debtor has either contracted, or who have suffered some kind of non-contractual injury at the debtor's hands. While each of these creditors have benefitted the debtor on account of providing value, the debtor cannot immediately compensate them all in

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62 *See* Baird, *infra* note 67, at 135 ("The view that the goal of bankruptcy law governing corporate debtors is to solve a common pool problem explains the general shape it should have, but it does not explain many of its details."); Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709, 1742 (2020), https://columbialawreview.org/wp-content/uploads/2020/11/Casey-Chapter_11s_Renegotiation_Framework_and_the_Purpose_of_Corporate_Bankruptcy.pdf (arguing that the Creditors' Bargain Theory "fails because it assumes away the bargaining costs that are at the core of the problem it is trying to solve").

63 *See* Casey, *supra* note 62, at 1738-41 (describing the various financial difficulties that distressed firms may have to handle, and the assorted constituencies with whom distressed firms may have to reckon during corporate reorganizations).

64 *See* Coase, *supra* note 45 at 2-15.

65 *See* Casey, *supra* note 62, at 1734-35 (explaining the different ways in which parties' contracts can be incomplete (citing Ayres & Gertner, *supra* note 49, at 730)).

66 *See* Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 100-01 (1984).

67 *See* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 881-82 (1996), https://openyls.law.yale.edu/bitstream/handle/20.500.13051/8933/36_105YaleLJ857_January1996_.pdf?sequence=2&isAllowed=y; Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEG. STUD. 127, 132-33 (1986). This proposition assumes that the investors' respective contractual and property interests will be respected. *Cf.* Butner v. United States, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.").

68 *See* 11 U.S.C. § 501(a) (allowing creditor to file proof of claim).

full and on ordinary payment terms.[69] Corporate reorganizations, then, are characterized by a debtor facing off against numerous creditors with whom the debtor has contracted (explicitly or implicitly), and the parties have not, and could not, predict the precise dynamics that the debtor faces.

Having failed to account for the particular circumstances surrounding a firm's failure, bankruptcy law pauses, if not nullifies, parties' respective remedies.[70] Such Draconian measures are justified in order to maximize the parties' joint welfare in the debtor's estate, which the parties would undermine if they were each allowed to pursue their non-bankruptcy remedies.[71] Instead, the parties are encouraged to reach a deal that would maximize the estate's value.[72]

A less sunny view is that parties will use whatever tools are at their disposal to increase their own recovery, the remaining parties be damned. A firm's senior (secured) creditors mayscrunch the firm's financial horizon and press for a quick sale of the firm's assets, even one that may not be at the highest price for the assets. This is because the secured creditors reap a limited upside if the firm emerges from Chapter 11 proceedings as a profitable enterprise, but face a far greater downside if the firm falters.[73] Junior (and frequently unsecured) creditors, for their part, will want some process—either a sale or a reorganization of the firm to operate as a going concern—that will at least give them a fighting chance of receiving some

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69 Though it is hard to conceive of how tort victims have "benefitted" the estate in virtue of being harmed by the debtor's tortious actions, bankruptcy law has long contemplated tort victims to have "benefitted" the estate when the estate commits a post-petition tort against the victims, since the victims' harms were part of the debtor's ordinary post-petition business operations. *See* Reading Co. v. Brown, 391 U.S. 471, 483-84 (1968). To the extent that the debtor tortiously harmed a victim in the ordinary course of business, the debtor must internalize that cost of doing business, much like it must internalize other costs that the debtor is contractually obligated to pay. *See id.*

70 *See, e.g.*, 11 U.S.C. § 362(a) (placing a stay on counterparties' actions seeking remedies against the debtor); *id.* § 363(l) (rendering unenforceable any "any provision … that is conditioned on the insolvency or financial condition of the debtor [or] on the commencement of a case under this title concerning the debtor … that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in … property").

71 *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 14-19 (Beard Books 2001); *see also* Douglas G. Baird et al., *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1679 (2018), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=9633&context=penn_law_review.

72 *See* 11 U.S.C. §§ 1121-1129 (establishing procedures for proposing and confirming a plan of reorganization); *Id;*. § 1141(d)(1)(A) (providing that confirmation of a plan "discharges the debtor from any debt that arose before the date of such confirmation"); United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983) ("In proceedings under the reorganization provisions of the Bankruptcy Code, a troubled enterprise may be restructured to enable it to operate successfully in the future.").

73 *See* David A. Skeel, *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L REV. 917, 937 (2003), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?referer =&httpsredir=1&article=1028&context=faculty_scholarship.

meaningful recovery.[74] The debtor's managers, who represent the firm's equity holders, can see the writing on the wall both before and after bankruptcy. With the firm facing financial distress and the prospect of the keys to the firm being handed to owners who are likely to replace old management, the firm's managers will take risks in an effort to retain their managerial positions.[75]

This cut-throat environment is precisely where principles of unjust enrichment should come in. Recall that the premise of any corporate reorganization is that each of the constituencies—senior lenders, junior lenders, and managers/equity holders—have previously given value to the debtor, and the debtor, facing financial distress, must decide alongside these constituencies what the optimal use of those assets are. Given their disparate interests, each constituency may attempt to slink away with value in a way that enriches itself at the expense of other parties. Failing to police these kinds of misconduct would not only be in some sense unfair to the other parties, but it would also require those parties to bear even greater monitoring costs in a bargaining environment that is already saturated with transaction costs.[76] Unjust enrichment principles must come into play to avoid these undesireable outcomes.

Unlike most cases, bankruptcy courts supervise the bargaining process that the parties undertake and must approve the deal that they strike. As we saw earlier, the law of unjust enrichment is meant to encourage parties to bargain among themselves.[77] Much like how courts do not rewrite the contracts that parties consummated when reviewing those contracts *ex post*, so too must bankruptcy courts not intervene based on their sense that one party or another got a "raw deal." The risk of judicial meddling is especially important in the bankruptcy context because the Bankruptcy Code contemplates that the court can confirm a plan of confirmation absent unanimous consent.[78] And distressed debt traders play an outsized role in corporate reorganizations; as such—to crib a turn of phrase from

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[74] *See* Lynn M. LoPucki & William C. Whitford, *Compensating Unsecured Creditors for Extraordinary Bankruptcy Reorganization Risks*, 72 WASH. U. L.Q. 1133, 1143 (1994) (noting that junior creditors have incentives to encourage risky investments in order to obtain some recovery); Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 693 (2003) (arguing that junior creditors, under certain conditions, will support a sale of a debtor's assets).

[75] *See* Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738, 755 (1988). *See also* Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CAL. L. REV. 745, 767-71 (2020) (showing how managers can opportunistically evade creditors' contractual control mechanisms to protect shareholders' investment in the firm, especially when the firm faces distress).

[76] *See supra* notes 49-61 and accompanying text.

[77] *See* 11 U.S.C. § 1128 (requiring court to hold a hearing on confirming plan of reorganization and allowing party in interest to object to the plan); *id.* § 1129 (providing that court must approve plan if it meets the enumerated requirements); *id.* § 363(b)(1) (allowing sale of debtor's property after "notice and a hearing").

[78] *See* 11 U.S.C. § 1129(b) (allowing plan proponents to "cram down" dissenting parties if enumerated requirements are met).

Professor Baird—no widows or orphans are harmed when parties deal sharply with one another.[79] But the monitoring costs that crop up as a result of unjust enrichment are real costs that may ultimately stymie parties' opportunities to make bargains in and out of Chapter 11 proceedings. Facilitating a healthy bargaining environment, as Professor Baird demonstrates, requires combatting this kind of opportunistic behavior.

The Bankruptcy Code, to be sure, comes equipped with mechanisms that are explicitly designed to prevent the parties from unjustly enriching themselves *ex ante*. The debtor in possession can unwind "fraudulent conveyances": transactions that, broadly speaking, divest funds from the distressed firm without providing the firm with any countervailing benefit.[80] So too a judge may equitably subordinate the creditor's claim to other creditors' claims if "a creditor has dominated or controlled the debtor to gain an unfair advantage," or "has committed some breach of an existing, legally recognized duty arising under contract, tort or other area of law" that is sufficiently egregious.[81]

Yet fostering *ex ante* rules about bargaining in Chapter 11 is tough stuff. Because firms fall into financial distress for myriad reasons, knowing how best to respond to a firm's particular kind of distress *ex ante*—given the firm's access to capital markets, current capital structure, cash flow, and so on—is close to impossible.[82] The dynamics at play in each case will vary accordingly. Left to their own devices, parties may try to covertly capture value for themselves.[83] This risk

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79 *See* BAIRD, *supra* note 2 at 140; *see also Exodus* 22:21 (JPS ed. 2006) ("You shall not ill-treat any widow or orphan.")

80 *See* 11 U.S.C. § 1107(a) (granting the debtor in possession most of the trustee's powers to administer the debtor's estate); *id.* § 548(a)(1) (allowing the trustee to unwind transactions made within two years of the debtor's bankruptcy filing that were either designed to "hinder, delay, or defraud" the debtor's creditors, or were such that the debtor did not receive "reasonably equivalent value" and the debtor was insolvent before, during, or as a result of the transaction). See also RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt. g (AM. L. INST. 2011) which notes that "the law of fraudulent conveyance … is obviously based on principles of unjust enrichment."

81 *See* In re 80 Nassau Assocs. v. Crossland Fed. Sav. Bank, 169 B.R. 832, 840 (Bankr. S.D.N.Y. 1994); 11 U.S.C. § 510(c)(1) (authorizing equitable subordination of a creditor's claim "under principles of equitable subordination"). *See also* RESTATEMENT § 57 (describing the equitable subordination remedy for unjust enrichment).

82 *See supra* notes 79-84 [63-70] and accompanying text.

83 *See* Baird & Jackson, *supra* note 66, at 107 ("No single group …, if unconstrained, will necessarily make a decision that is in the best interests of the owners considered together."). *See also* 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE, AS ADMINISTERED IN ENGLAND AND AMERICA § 378 (10th ed., Isaac F. Redfield, ed., Little, Brown & Co. 1870) (condemning "that not infrequent class of cases, in which, upon failure or insolvency of their debtors, some creditors have, by secret compositions, obtained undue advantages, and thus decoyed other innocent and unsuspecting creditors … when … there was a designed or actual imposition upon all but the favored few").

is especially pronounced when it comes to insiders, who likely have private information that they can use to engage in self-dealing.[84]

This is why it is essential for bankruptcy judges to be able to police this kind of misconduct *ex post*. Corporate reorganizations are constantly evolving; parties can maximize value in ways that were not previously possible, but they can also use new techniques to divert value away from the estate to enrich themselves.[85] Unjust enrichment principles allow judges to combat this kind of misconduct once they have sufficient signs that mischief is afoot.[86] Bankruptcy judges can tamp down on this kind of opportunism, for example, by refusing to confirm a plan because it is not "proposed in good faith,"[87] or "fair and equitable."[88] Doing so is essential for ensuring that parties maintain efficient monitoring precautions that in turn will promote healthier bargaining both ex post and ex ante.

Voting dynamics illustrate the role that unjust enrichment principles play in regulating Chapter 11 bargaining dynamics. Every proposed plan of reorganization must siphon creditors and equity holders into classes of claims and interests, respectively,[89] and the plan must "provide the same treatment for each claim or interest of a particular class."[90] Each class, in turn, may only include claims or interests that are "substantially similar to the other claims or interests of such class."[91] Yet for the bankruptcy court to confirm the plan, at least one impaired class must vote in favor of the plan if it features any impaired classes of claims or interests.[92] In an effort to make the plan confirmable, proponents can try to

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[84] *See* Kenneth Ayotte & David A. Skeel Jr., *Bankruptcy Law as Liquidity Provider*, 80 U. CHI. L. REV. 1557, 1580 (2013) ("[I]t is likely that parties with an existing relationship with the firm, such as existing managers and lenders, will have access to inside knowledge and experience. These parties can forecast the firm's future value more accurately than outside parties due to inside information."); BAIRD, *supra* note 2, at 149 (discussing bankruptcy judge's ability to reject a plan that gives a hefty payment to the firm's former CEO who is now retired).

[85] *See, e.g.*, BAIRD, *supra* note 27 at 215-28 ("Compounding the problem of so much being hidden from view, the dynamics of large Chapter 11 cases today are different from what they were only a few years ago.").

[86] *See* BAIRD, *supra* note 2, at 155; Smith, *supra* note 62, at 1108 (noting equity's flexibility allows it to respond to opportunistic behavior, which "is inherently open-ended").

[87] *See* 11 U.S.C. § 1129(a)(3).

[88] *See* 11 U.S.C. § 1129(b)(1); BAIRD, *supra* note 1, at 145,149. *See also In re* D&F Construction, Inc., 865 F.2d 673, 675 (5th Cir. 1989) ("A court must consider the entire plan in the context of the rights of the creditors under state law and the particular facts and circumstances when determining whether a plan is 'fair and equitable.'").

[89] *See* 11 U.S.C. § 1123(a)(1).

[90] *Id.* § 1123(a)(4). Each claim or interest holder is allowed to opt for "less favorable treatment" relative to the rest of its class members. *Id.* A plan must still treat such a claim or interest according to the dictates of section 1129(a)(9).

[91] *Id.* § 1122(a).

[92] *Id.* § 1129(a)(10). An impaired class is one whose members' rights are altered by the plan. *See id.* § 1124.

aggregate claims or interests into the same class, or partition them into separate classes in an effort to "gerrymander" votes.[93]

The "anti-gifting principle" also illustrates the bankruptcy judge's role in policing misconduct *ex post*.[94] A senior lender may receive a distribution under a plan and try to "gift" part of it to some, but not all, junior lenders.[95] On first pass, senior lenders are entitled to do with their property what they wish and, as such, may give any value that they would like to anyone, including any other party to the corporate reorganization.[96] But allowing gifts leaves open the possibility that senior lenders may collude with shareholders in order to extract value from the firm at the junior lenders' expense.[97] The "anti-gifting principle" is a specific response to a broader concern that insiders will abscond from the Chapter 11 proceedings with value in less than an above-board fashion.[98]

The difficulty, of course, is that there can be relatively innocent explanations for separating claims into different classes and "gifting" assets to equity holders. Placing facially similar claims into separate classes might be justified if those claimholders represent very different constituencies within the distressed firm.[99] Similarly, "gifting" can simply be a tactic for more senior lenders to encourage old equity holders to invest in the reorganized firm, and opposing the gift would not benefit the estate or even the objecting party.[100] The key, as

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[93] *See* BAIRD, *supra* note 27, at 249-52 (discussing classification dynamics and the prospect of vote gerrymandering in Chapter 11 cases).

[94] *See* BAIRD, *supra* note 1, at 145.

[95] *See* BAIRD, *supra* note 27, at 72. The anti-gifting principle is especially problematic under a system of absolute priority, which requires that junior investors receive nothing in the restructured firm on account of their investment unless the senior investors are compensated in full. *See* Bank of Am. Nat. Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 444-49 (1999). Professor Baird believes that the New Dealers erred in assuming that corporate reorganizations needed to use the absolute priority rule and not a relative priority rule. *See* BAIRD, *supra* note 1, at 93-98. I do not want to wade into that debate here, nor need I do so. Gifting raises the specter that an insider is using value to benefit a favored party at the estate's expense. That concern applies even if the absolute priority rule does not. *See id.* at 143.

[96] *See In re* SPM Mfg. Corp., 984 F.2d 1305, 1313 (1st Cir. 1993) ("[C]reditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including to share them with other creditors.").

[97] *See In re* DBSD N. Am., Inc., 634 F.3d 79, 100 (2d Cir. 2011) ("Shareholders retain substantial control over the Chapter 11 process, and with that control comes significant opportunity for self-enrichment at the expense of creditors.").

[98] *See* BAIRD, *supra* note 1, at 145; Richard Levin, *A Response to Professor Baird's Essay on Unwritten Law: Writing Some Unwritten Law*, 36 EMORY BANKR. DEV'S. J. 729, 733 (2020) ("[N]on-Code distributions to parties who might have legal or actual control over the estate, or the debtor, are prima facie improper and should be subject to higher scrutiny, just as courts impose higher scrutiny on interested party transactions under the business judgment rule.").

[99] *See* BAIRD, *supra* note 27, at 270-74.

[100] *See* Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit's* Armstrong *Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 AM. U. L. REV. 1345, 1420-23 (2006). *See also*

Professor Baird notes, is for judges "to understand the dynamics behind the proposals that are put before them."[101] Only then can they discern whether maneuvers, like claim classification and gifting, are parties' attempts to unjustly enrich themselves at the expense of the estate.

In re Platinum Corral, LLC illustrates the supervision a bankruptcy court must exercise when reviewing claim classification and gifting concerns, individually and in-tandem.[102] There, the debtor was a Golden Corral franchisee, at one time operating twenty-eight Golden Corral restaurants across six states, but reducing their operations to twelve restaurants due to economic pressures stemming from the COVID-19 pandemic.[103] L. William Sewell III was the debtor's CEO and president who owned 87.5% of the debtor.[104] Relevant to the analysis here, the debtor had $6.5 million in unsecured trade debt claims, and roughly $14.7 million in two unsecured notes issued to Sewell.[105] Under the debtor's proposed plan, the trade debt claims and Sewell's claims were segregated into different classes and treated separately. The trade debt claims would receive over eighteen cents on the dollar.[106] Sewell would receive all the equity in the reorganized debtor in exchange for his unsecured claims and $100,000 in fresh cash, despite the fact that the debtor's expert estimated the debtor's value at $0.[107] The Unsecured Creditors' Committee objected to the plan, alleging that the debtor improperly placed the trade creditors and Sewell's claims into separate classes, despite all of the claims being general unsecured claims.[108] The Committee further protested that Sewell's unsecured claim was a capital contribution, and by giving him all the equity in the reorganized debtor, the plan violated the absolute priority rule when the opportunity to obtain the equity was not extended to other creditors and the debtor's value as a going concern was not market-tested (notwithstanding Sewell's additional $100,000 contribution).[109]

The court held that the trade debt and Sewell's claims were rightly placed in separate classes.[110] A closer look at Sewell's claims revealed that while the first note (of almost $13.8 million) was a run-of-the-mill unsecured promissory note,

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Kan. City Terminal Ry. v. Cent. Union Tr. Co., 271 U.S. 445, 455 (1926) ("Generally, additional funds will be essential to the success of the undertaking, and it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them.").

101 *See* BAIRD, *supra* note 1, at 151.

102 In re Platinum Corral, LLC, No. 21-00833-5-JNC (Bankr. E.D.N.C., Jan. 13, 2022).

103 *Id.* at *1.

104 *Id.*

105 *Id.* at *1-3.

106 *Id.* at *2.

107 *Id.* at *2-3.

108 *Id.* at *5.

109 *Id.* at *3-4.

110 *Id.* at *16.

the second note (of roughly $900,000) was a capital contribution because it was used to increase the debtor's capital ratio so that the debtor could acquire new secured financing.[111] Even though Sewell only had one claim that remained characterized as an unsecured debt, the court held that it was proper for the debtor to classify Sewell's claim separately from the trade debt claims. The latter were short-term debts incurred in the debtor's ordinary course of business, while Sewell's claim was a "long-term insider debt" for which Sewell did not expect prompt payment.[112] Treating Sewell's claim separately comported with the fact that no other unsecured creditor was eligible to become, or interested in becoming, a Golden Corral franchisee.[113] That opportunity was Sewell's alone, and Sewell was interested in acquiring the equity in the reorganized debtor—not being paid cents on the dollar.[114] The court concluded by explaining that "[w]hether [Sewell] should be provided with that opportunity is not a question of class division."[115]

Though not a question of class division, Sewell's opportunity to purchase the reorganized debtor's equity raised the court's suspicions. Sewell was the debtor's CEO, president, and majority shareholder, making him responsible for crafting the debtor's plan and therefore making any such plan inherently subject to increased scrutiny.[116] Sewell had to offer the right to purchase some of the equity to the other unsecured creditors or, at the very least, offer them some other form of consideration sufficient to account for the lost opportunity to obtain equity in the reorganized debtor.[117] Sewell's injection of $100,000 in cash did not convince the court to approve the debt-for-new equity aspect of the plan either. While the debtor's expert estimated the debtor's going concern value to be $0, the court explained that it had to discern the debtor's going concern value from the market.[118] Without that crucial information, the court could only speculate whether Sewell's $100,000 new value contribution was reasonably equivalent value in exchange for 100% of the reorganized debtor's equity.[119] Lastly, the debtor projected that it would accrue $2.8 million in retained earnings over the five years after the court confirmed its plan.[120] Under the debtor's plan, Sewell alone stood to gain from that projected success.[121] Though Sewell may have been the only person who could obtain equity in the reorganized debtor and may have offered the highest price for

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111 *Id.* at *11-13.
112 *Id.* at *15.
113 *Id.* at *16.
114 *Id.*
115 *Id.*
116 *Id.* at *19.
117 *Id.* at *19-20. Offering a different kind of consideration was especially important because the Golden Corral franchisor was not accepting new members to its franchise. *See id.* at *16.
118 *Id.* at *21-22.
119 *Id.* at *23.
120 *Id.* at *24.
121 *Id.*

it, the debtor's proposed plan could not be confirmed without market-testing those propositions.[122]

Platinum Corral shows how bankruptcy judges must properly identify the locus of mischief in order to combat it. The fact that the unsecured claims were classified separately was not problematic; rather, the way in which those claims were treated was a cause for concern. Absent any market test, Sewell stood to be potentially unjustly enriched from obtaining all the reorganized debtor's equity.

To be sure, he also stood to lose; if the debtor collapsed after it emerged from Chapter 11 proceedings, Sewell would be entirely out of pocket for his $13.8 million claim. And Golden Corral's franchisor seemed closed to the possibility of accepting new or additional franchisees. But one must cast a curious eye on the deal here. Sewell offered to surrender his $13.8 million unsecured claim and contribute an additional $100,000 in exchange for the enterprise, one that the debtor's expert valued at $0. Such an asymmetrical exchange potentially suggests an insider's self-dealing—a risk exacerbated when the new equity holder is the old debtor's CEO, president, and majority shareholder. It was possible that Sewell should inherit the role as the sole equity holder of the reorganized debtor, but the court rightly required that the debtor provide additional information about the firm's value and the presence of other investors willing to purchase equity.

To sum up, high transaction costs preclude parties from fully spelling out their obligations to each other when one of them becomes financially distressed. Core bankruptcy tools help mitigate the fallout from those contractual shortcomings so that the parties can adjust their rights accordingly. Chapter 11 proceedings, however, are chock-full of transaction costs, where the debtor has valuable assets and varying, opposing constituencies have been incentivized to capitalize on those assets for their own gain at the expense of others. Unjust enrichment principles undergird the unwritten law of corporate reorganizations and allow judges to mop up any issues that the parties could not resolve on account of high transaction costs. This judicial intervention, however, is to reduce transaction costs so that the parties can bargain more easily both in and out of Chapter 11 proceedings.[123]

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122 *Id.* at *24-25.

123 Of course, the parties may end up failing to reach a deal even in the absence of transaction costs. For example, Professor Baird describes the "empty core" problem, where three or more parties cannot reach a deal because reaching a deal requires prejudicing at least one of the parties, and the members of the coalition that forms the privileged majority can defect to form a new coalition with the prejudiced party to get an even better deal. *See* BAIRD, *supra* note 1, at 128-29. Since each party has the opportunity to propose this kind of plan and at least one other party will be frozen out by such a plan, the parties will not be able to reach a stable deal. *Ibid.*

IV: UNJUST ENRICHMENT AND MASS TORT BANKRUPTCIES

Professor Baird's relatively hands-off approach to corporate reorganizations works because the parties are sophisticated actors seasoned in navigating distressed debt situations. As we saw earlier, parties all along the firm's capital structure have ostensibly priced-in the risk of the firm's financial distress into their investments.[124] Some of them may have hedged their bets by occupying a mix of different positions in the firm;[125] others may have invested in the firm in sunnier times and sold their claims to professional debt investors when the firm entered a period of distress.[126] Sure, corporate reorganizations are necessary to address the issues that emerge due to unavoidable transaction costs, and bankruptcy judges still must vigilantly quash opportunistic behavior (not to mention outright fraud). Yet, general cries of "unfairness" will ring hollow.[127] So long as the parties to a reorganization can bargain in good faith to advance their own interests, they cannot complain if the reorganization does not shake-out in their favor.[128] And to the extent that a corporate reorganization features consumer creditors, sophisticated parties are likely to agree to honor the consumer creditors' claims as an important step in setting the distressed firm on good financial footing.[129]

Bankruptcy scholars, including Professor Baird, have recognized how corporate reorganizations centering on mass torts clash with this neat picture.[130]

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124 *See supra* note 67 and accompanying text; BAIRD, *supra* note 1, at 140 ("In the modern world of corporate reorganizations, many of the players are distressed debt investors who buy and sell their positions because they believe that they know more than others.").

125 *See* BAIRD, *supra* note 1, at 156 (observing a development in corporate reorganizations "that became more important in recent years was that of dealing with a creditor who wears two different hats" in the firm's capital structure").

126 *See* Jared A. Ellias, *Bankruptcy Claims Trading*, 15 J. EMPIRICAL LEGAL STUD. 772, 778 (2018) (finding "that most large Chapter 11 cases appear to involve heavy trading in bond debt").

127 *See* Skeel, *supra* note 40, at 742-43 (arguing that the "equality of the creditors" norm is inapplicable in bankruptcy when creditors can bargain their respective entitlements with the debtor and each other).

128 *Cf.* N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 508 (1913) ("If [a party] declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it.").

129 *See* BAIRD, *supra* note 1, at 166-67. *But see* Buccola, *supra* note 34, at 1573-76 (explaining that the unwritten law prejudices "legacy creditors," who cannot make new investments in the firm).

130 *See, e.g.*, Douglas G. Baird, *A World Without Bankruptcy*, 50 LAW & CONTEMPORARY PROBLEMS 173, 180 (1987); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay in Bankruptcy Sharing and the Creditor's Bargain*, 75 VA. L. REV. 155, 178 (1989) ("Distributions to nonconsensual claimants are conceptually different from those that would be agreed to in any bargain in which individual self-interest was a central feature."); Christopher M.E. Painter, Note, *Tort Creditor Priority in the Secured Credit System: Asbestos Times, the Worst of Times*, 36 STAN. L. REV. 1045, 1054-55 (1984) (observing that tort victims have "no opportunity to assess the risk of insolvency, choose the debtor with whom [they] will bargain, bargain for additional compensation, or demand security").

Tort victims as creditors of a firm present a unique transaction cost problem. Those tort victims did not allocate their rights at all, much less their rights when the firm faced financial distress.[131] Bankruptcy law may be an effective mechanism for addressing these claims, but tort victims face the risk that they will be undercompensated for the harms that they suffered at the firm's hands. This raises both tort and unjust enrichment concerns: not only would this fail to incentivize firms to take proper precautions or reduce activity levels,[132] but sloughing-off tort liabilities benefits the firm by allowing it to access capital to an extent that would otherwise be difficult to achieve if the tort liabilities lingered.[133] Using bankruptcy to address mass torts, then, raises the possibility that firms will benefit from harming tort victims.

That risk is especially pronounced when firms use tactics to limit their tort liability exposure, such as creating product-specific subsidiaries to insulate the parent firm from tort liability.[134] Johnson & Johnson's recent use of the so-called "Texas Two-Step" raises the stakes by placing the firm's talc liabilities, along with Johnson & Johnson's guarantee to fund the payments for those liabilities, into a separate entity.[135] This maneuver has generated both academic and public concern about how the firm's talc victims will be treated, both procedurally and substantively.[136] Even the bankruptcy court that initially blessed Johnson & Johnson's use of the "Texas Two-Step" to place its talc liabilities into bankruptcy recognized how firms may use the tactic to jettison their liabilities without placing the firm—assets, liabilities, and all—into bankruptcy.[137] Firms have also used third-party releases to shield non-debtors, such as a firm's shareholders or its parent company, from liability associated with the firm's tort liabilities when applicable

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[131] *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 755 & n.17 (2002) (arguing that corporate reorganizations are unnecessary for increasingly common cases that predominantly feature commercial creditors, who increasingly control debtors via contractual mechanisms, but noting that corporate reorganizations remain appropriate "[w]hen involuntary tort victims loom large in the capital structure").

[132] *See* Painter, *supra* note 130, at 1058-63.

[133] *See* Mark. J. Roe, *Corporate Strategic Reaction to Mass Tort*, 72 VA. L. REV. 1, 51-55 (1986) (noting strategies that investors may induce the firm to adopt in order to hedge the risk of a mass tort bankruptcy).

[134] *Id.* at 39-40.

[135] *See* Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. ONLINE 38, 40-41 (June 2022), https://michiganlawreview.org/texas-two-stepping-out-of-bankruptcy/, (explaining the Texas Two-Step).

[136] *See, e.g.*, Charles P. Pierce, *Johnson & Johnson Is Trying the 'Texas Two-Step' to Avoid Accountability*, ESQUIRE (Sept. 13, 2022), https://www.esquire.com/news-politics/politics/a41191693/johnson-and-johnson-bankruptcy/. *See generally* Francus, *supra* note 135 (exploring how the Texas Two-Step places procedural hurdles in front of tort claimants, potentially limiting their recoveries).

[137] *See* In re LTL Mgmt., LLC, 637 B.R. 396, 409-10, 423-24 (Bankr. D.N.J. 2022) (3d Cir. 2023).

non-bankruptcy law would potentially expose those constituencies to such culpability.[138]

How best to respond to tort victims as creditors of a distressed firm is subject to debate. Proposals range from allowing tort victims to sue a distressed firm's shareholders for any damages that they could not collect from the firm,[139] to giving tort victims "super-priority" over the firm's other creditors (secured and unsecured alike),[140] to allowing tort victims to sustain their claims against the firm's assets (even if a third-party purchases those assets),[141] to operating the firm as a going concern for the public benefit with tort victims as the firm's shareholders.[142]

While each of these proposals has its respective merits, it is also important to identify how the unwritten law—designed by and for seasoned restructuring professionals—may procedurally freeze-out tort claimants.[143] As Professor Lindsey Simon points out when discussing channeling trusts in mass tort bankruptcies, a debtor may propose a plan that offers to fund a trust for the victims up to a set amount, but the victims may not know what they would receive from the trust or if they were able to litigate their claims in federal or state court.[144] Sharp elbows are to be expected when sophisticated actors alone play in the sandbox. When tort victims are in the mix, different rules are called for.

Unjust enrichment principles suggest heavily modifying that unwritten law for the mass tort context. A sophisticated, voluntary creditor will nearly always know the face value of their non-bankruptcy entitlements, and can therefore bargain with other parties in the shadow of that face value. All that the bankruptcy judge is left to do—though far from easy—is to forge a healthy bargaining environment and prevent parties from slinking away with value. Without sufficient procedural safeguards, a distressed firm may shortchange tort victims by requiring victims to pay for individualized assessments under the channeling trust, limiting the victims' right to appeal their recoveries, and requiring the victims to assess the firm's proposed plan without sufficient information.[145]

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[138] *See* Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154, 1166-76 (2022) (explaining the history and use of nondebtor releases).

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

[140] *See* Painter, *supra* note 130, at 1080-83.

[141] *See* Vincent S.J. Buccola & Joshua C. Macey, *Claim Durability and Bankruptcy's Tort Problem*, 38 YALE J. REG. 766, 783-95 (2021).

[142] *See* Samir D. Parikh, *Scarlett-Lettered Bankruptcy: A Public Benefit Proposal for Mass Tort Villains*, 117 NW. L. REV. 425, 461-71 (2022).

[143] *See* Buccola, *supra* note 34, at 1572-79.

[144] *See* Simon, *supra* note 138, at 1188-1204.

[145] *See id.* at 1209-14 (describing procedural precautions that courts can take to protect tort victims' interests).

Procedural protections may not exhaust the suite of policies necessary to protect tort victims in mass tort bankruptcies. But those policies, whatever they may be, will ultimately draw on the unjust enrichment principles that undergird the unwritten law of corporate reorganizations. Those principles, in turn, call for modifying the unwritten law in mass tort cases to allow tort victims to bargain on more equal footing with tortfeasor debtors.

V: CONCLUSION

As a guide through the centuries of corporate bankruptcy law, Professor Baird illustrates that while much in corporate reorganizations has changed, the fundamentals are timeless. Bankruptcy courts have the authority, dating back to Statute of 13 Elizabeth, to void transactions that transfer value away from the estate. But, as the demise of Chapter X illustrates, those principles do not allow bankruptcy courts to salvage "worthy" debtors or privilege "favored" creditors. Reducing transaction costs among the parties is the goal; beyond that, bankruptcy courts must let the parties duke it out among themselves.

As I have shown, the unwritten law of corporate reorganization embodies unjust enrichment principles. Heading-off nonconsensual transfers helps reduce monitoring costs, which in turn helps facilitate bargaining—the way in which parties should allocate their entitlements. Preventing unjust enrichment in this context requires the judge to carefully balance between intervening when parties try to maximize their personal returns at the estate's expense, and withdrawing when the parties determine the best use of the firm's assets going forward.

Unjust enrichment principles call for different treatment in mass tort bankruptcies. There, thumbs on the scale are appropriate. Tort victims should have a full and fair opportunity to understand the value of their underlying tort claims and to compare that value to the compensation that they can expect to receive under the debtor's plan.

The genius of Professor Baird's book is that it provides a framework for corporate reorganizations of all kinds. We can only benefit by returning to it, even, and especially, when addressing the most difficult issues at the periphery of corporate reorganizations.