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Generalized Creditors and Particularized Creditors: Against a Unified Theory of Standing in Bankruptcy

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A triangle exists between a debtor, a debtor’s general creditors, and a third party who has injured the debtor’s net worth. When that injury to net worth is so severe that the debtor is rendered insolvent, the general creditors of the debtor are indirectly injured. The question then arises: Who has standing to sue the third party for alleged wrongdoing?

The triangle was on display in the celebrated chapter 11 plan recently confirmed by Judge Robert D. Drain in In re Purdue Pharma L.P.\(^1\) In this case, a debtor corporation caused trillions of dollar in damages\(^2\) through the marketing of OxyContin, a heroin-based pain killer. Over the years, Purdue issued billions in dividends to the Sackler family. These dividends may have been fraudulent transfers. Possibly they augured breach of fiduciary duty or constituted a justification for piercing the corporate veil between Purdue and the Sacklers. In chapter 11, a settlement was negotiated and written into a reorganization plan, which won overwhelming creditor support.\(^3\) The settlement garnered virulent criticism in the press, however, because it included a “channeling” injunction that protected the Sacklers from law suits by creditors of Purdue in exchange for a payment to the plan of $4.325 billion. This settlement left the Sacklers with about $6 billion in net worth,\(^4\) enough to keep them in tea and crumpets for quite a while.

Since then, Judge Drain’s confirmation order has been reversed on appeal.

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\(^{1}\) Id. at 53 (Bankr. S.D.N.Y. 2021), rev’d, 635 B.R. 26 (S.D.N.Y. 2021).

\(^{2}\) Id. at 64 ($40 trillion).

\(^{3}\) Various classes voted well in excess of the two-thirds margin required by Bankruptcy Code § 1126(c). Id. at 106.

\(^{4}\) Id. at 88 (estimating Sacker collective net worth at $11 billion and noting settlement amount of $4.325 billion).
The Sacklers have returned to the negotiation table and have agreed to pay more than they originally agreed. In response, many of the appellants have dropped their opposition to Purdue’s appeal, but the United States Department of Justice continues to oppose Purdue’s attempt to have confirmation reinstated. Purdue therefore continues to appeal.\footnote{See Mediators’ Fourth Interim Report Case No. 19-23649 (RDD) March 3. 2022, Jonathan Randles, \textit{Justice Department Appeal Threatens $6 Billion Sackler Opioid Settlement}, \textit{Wall Street Journal} (March 21, 2022) https://www.wsj.com/articles/justice-department-appeal-threatens-6-billion-sackler-opioid-settlement-11647886850?page=1.}

We think the plan as written is confirmable. Oddly, Judge Drain’s interpretation of the plan is so expansive that, as interpreted, the plan is not confirmable. In passing, we will defend confirmability of the plan \textit{as written}.\footnote{This we document in great detail in a forthcoming manuscript. Jeanne L. Schroeder & David Gray Carlson, \textit{Third Party Releases Under the Bankruptcy Code After Purdue Pharma}, 21 \textit{Am. Bankr. Inst. L. Rev.} 1 (2023) (forthcoming).} But that is not our main task. What we aim to do is to illustrate the triangle we have alluded to. Who had the right to sue the Sacklers? If that right belonged solely to the bankruptcy estate, the confirmation order was lawful. If that right belonged to individual creditors with tort claims against the Sacklers, the confirmation was unlawful. Since the plan \textit{as written} affects only property of the estate (not property of the tort victims), the plan properly could be confirmed, and the Sacklers continue to be liable for tortious conduct that harmed the victims of OxyContin.

As to our fateful triangle, we illustrate it as follows: suppose the insolvent debtor files for bankruptcy, conjuring a bankruptcy trustee into existence. The bankruptcy trustee would like to sue the third party and recover damages, which then would be distributed pro rata to the unsecured creditors. A given unsecured creditor, however, would like to sue the third party directly, in which case she would receive 100 percent of the recovery (if the third party is solvent), without having to share with her slow-footed fellows. The question arises whether either the bankruptcy trustee, the individual creditor, or both can sue the third party.

Courts have searched for a unified theory of standing to determine this issue. Everyone agrees that if the debtor (whom we shall call D or \textit{D Corp.}) has a tort or a breach of contract theory against the third party (whom we shall call X), the bankruptcy trustee (T) succeeds to this right. D’s creditor (whom we shall call C) has no right to sue X. Outside of bankruptcy, if C has a money judgment against D, C can execute on D’s property. C can garnish X’s obligation to pay D, because D’s “payment intangible”\footnote{U.C.C. § 9-102(a)(62) (Am L. Inst. & Unif. L. Comm. 1977).} is leviable property. But once D files for bankruptcy, C is enjoined from executing on D’s property. Only D’s bankruptcy trustee may collect from X.
Sometimes state law endows C with rights directly against X. D's bankruptcy trustee (T) sometimes displaces each general creditor (Cg) as the proper plaintiff against X. Sometimes, however, T fails to displace C. C may sue X and T may not.

A theory has emerged to adjudicate when T expropriates rights from the Cg, and that unified theory is the main focus of our criticism. It is said that when every Cg has a right against X, then T displaces the Cg, and T alone can be the plaintiff against X.9 These are referred to as generalized or derivative creditor rights. A generalized creditor right is one that is derivative of a right of all the Cg against D Corp.10 If, however, only some of the Cg have rights against X, T has no right against X. Rather, the subset of Cg can be plaintiffs against X and T cannot be a plaintiff. These are called particularized or non-derivative creditor rights. Particularized creditor rights are not merely derivative of the Cg's right against D Corp. Many courts think that the test of general v. particular (or derivative v. not derivative) determines the proper plaintiff when D is bankrupt and the Cg have been injured.

Some courts, however, have questioned the worth of such a test. Generalized v. particularized has been deemed "not an illuminating usage."12 The terms have been described as conclusory—not a test but rather the enunciation of a result. Thus generalized v. particularized creditor rights "are perhaps best understood as descriptions to be applied after a claim has been analyzed to determine whether it is properly assertable by the debtor or creditor, and not as a substitute for the analysis itself."

We think these criticisms are valid. "General" and "particular" do not succeed in stating in advance whether T or C1 is the proper plaintiff. Discrete categories of creditor rights must be examined. The distinction between generalized and particularized creditor rights does no work at all. The distinc-

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9The Cg are the unsecured general creditors of D Corp., not yet determinate because they have not commenced a law suit. When we refer to C1 or C2, these are specific individual creditors of D Corp. who have asserted rights against X. {C1, C2} ∩ Cg.

9Koch Refining v. Farmers Union Central Exchange, Inc., 831 F.2d 1339, 1349 (7th Cir. 1987) ("[A] single creditor may not maintain an action on his own behalf against a corporation's deficiencies if that creditor shares in an injury common to all creditors and has personally been injured only in an indirect manner.").

10Continental Cas. Co. v. Carr (In re W.R. Grace & Co.), 607 B.R. 419, 432 (Bankr. D. Del. 2019), rev'd 13 F.4th 279 (3d Cir. 2021) (defining derivative claim as one where "the harm the plaintiffs allegedly suffered at the hands of [a third party] was the same harm suffered by all the debtor's creditors").

11Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.), 855 F.3d 84, 100 (2d Cir. 2017) (nonderivative claims "are personal to the individual creditor and of no interest to the others"); Marshall v. Picard (In re Bernard L. Madoff Inv. Secs. LLC), 740 F.3d 81, 89 (2d Cir. 2014) ("An injury is said to be 'particularized' when it can be 'directly traced to [X]'s conduct'" (citation omitted).

12See, e.g., Steinberg v. Bucynski, 40 F.3d 890, 893 (7th Cir. 1994).

13Highland Capital Mgmt. LP v. Chesapeake Energy Corp. (In re Seven Seas Petroleum, Inc.), 522 F.3d 575, 588 (5th Cir. 2008).
tion is otiose. Or it misleads courts down the dallying path of primrose error, where generalized v. particularized is consulted directly without first performing an analysis of the substructure out of which the controversy arises.

The very paradigm of generalized creditor rights is (wrongly) thought to be the fraudulent transfer. According to the Fifth Circuit Court of Appeals:

A typical fraudulent transfer claim is perhaps the paradigmatic example of a claim that is 'general' to all the creditors . . . It is normally the debtor's creditors, and not the debtor itself, that have the right to assert a fraudulent transfer claim outside of bankruptcy, but in bankruptcy such a claim is usually brought by the trustee, for the benefit of all creditors. This is because the claim is really seeking to recover property of the estate.\footnote{Id. at 589 n.5 (5th Cir. 2008); see also Tronox, 855 F.3d at 106 (fraudulent transfer claims are "the paradigmatic example of claims general to all creditors").}

This passage needs to be unpacked. Suppose $D$ is insolvent and owns a gold brick. The $C_g$ so far have no judgments against $D$ and no interest in the brick. $D$ has the fee simple of it. Anticipating the $C_g$ lawsuits, $D$ conveys the fee simple of the brick to $X$. Once she does so, $D$ has no interest in the brick and $X$ has legal title to it. Therefore, says the above-quoted passage, $D$ has no right to retrieve the brick from $X$. But the $C_g$ have the right to execute on the brick. The $C_g$ are invited to "set aside" or "avoid" the $D$-$X$ transfer. Equity is willing to aid the $C_g$ in establishing a judicial lien on the brick. Therefore, it is said, $X$ has legal title to the brick, but the $C_g$ have equitable title.\footnote{On the nature of fraudulent transfer law as purely a property concept, see David Gray Carlson, \textit{Fraudulent Transfers as a Tort}, 2022 MICH. ST. L. REV. (forthcoming); David Gray Carlson, \textit{Fraudulent Transfers: Void and Voidable}, 29 AM. BANKR. INST. L. REV. 1 (2021); David Gray Carlson, \textit{The Logical Structure of Fraudulent Transfers and Equitable Subordination}, 45 WM. & MARY L. REV. 157 (2003).} The above passage says that the $C_g$ right is a generalized creditor right. When $D$ is bankrupt, $D$'s bankruptcy trustee expropriates this generalized creditor right. $T$ may sue $X$ for the brick and the $C_g$ may not. We shall see, however, that particularity rears its head and snarls from the foetid pool of fraudulent transfer law. Fraudulent transfer law cannot be fairly characterized as a generalized creditor right. In fact, we will show that generalized creditor rights do not exist. Either a creditor has a cause of action (which only in the case of fraudulent transfers passes to $T$),\footnote{11 U.S.C. § 544(b)(1).} or $D$ has "property"—some tort theory against $X$. Accordingly, there is no such thing as a particularized creditor right. There is only a creditor right—or there is no creditor right.

The paradigm of a particularized creditor right is supposed to be supplied by the well-known case of \textit{Caplin v. Marine Midland Grace Trust Co. of...
New York. In Caplin, D Corp. issued a debenture for which an indenture trustee (IT) was appointed to supervise receipt and distribution of debt service. Various investors (the CI) bought these unsecured debentures. IT had duties of due care to the CI.

D Corp. went bankrupt. T sued IT for fraud or negligence. T claimed to be subrogated to the CI right to sue IT for damages. IT moved to dismiss because T had no “standing” derived from the CI. The Supreme Court upheld the dismissal. It can easily be seen that the CI had particularized creditor rights. D Corp. had about $60 million in debts and the CI claims amounted to under $5 million. Thus, most Cg had no claim against IT. In set theory terms, the CI were a proper subset of the Cg. (CI?Cg). The propriety of the subset guarantees that the rights of the CI are particularized creditor rights, not generalized rights.

This article surveys the generalized v. particularized distinction and finds it wanting. Our suggestion is that the generalized/particularized dichotomy (or the derivative/nonderivative dichotomy) be permanently banished from legal discourse. Instead, we should speak of D’s prepetition causes of action (which are property of the bankruptcy estate), fraudulent transfer rights of the Cg (to which T is subrogated), and CI’s right to sue X directly because D did not or could not pay CI (not property of the bankruptcy estate).

Part I discusses corporate looting cases—oft confused with fraudulent transfer cases. If X has stolen assets from D Corp., D Corp. has a cause of action against X. The Cg have no cause of action against X. D Corp.’s cause of action becomes property of the bankruptcy estate under Bankruptcy Code § 541(a)(1). Courts err when they refer to generalized creditor rights in corporate looting cases.

Part II examines constructive trust theories, where D Corp. has defrauded victims of their property. These too are often confused with fraudulent transfer theories—especially in Ponzi scheme liquidations. Properly, the victims are not even creditors. They are property owners, claiming the equitable interests in the property of which they were defrauded. These equitable interests never pass to T under Bankruptcy Code § 541(a)(1). It is inappropriate to conclude that constructive trust is a particularized creditor

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17Id. at 416 (“The sole issue in this case is whether [T] has standing under Chapter X of the Bankruptcy Act . . . to assert, on behalf of persons holding debentures issued by [D Corp], claims of misconduct by an indenture trustee”).
18That is, CI is included in the set of the Cg. See generally Jeremy N. Sheff, Legal Sets, 40 CARDOZO L. REV. 2029 (2019).
right. It is not a creditor claim at all. It is a property claim belonging to a third-party noncreditor.

Part III investigates fraudulent transfer theories and finds they do not yield generalized creditor rights. Sometimes only a proper subset can do so. Not all creditors can avoid a fraudulent transfer. Nevertheless, \( T \) has exclusive dominion over fraudulent transfer claims under Bankruptcy Code § 544(b)(1). The concept of generalized creditor rights explains nothing, since fraudulent transfer claims are particularized.

Part IV investigates the phenomenon known as piercing the corporate veil. This is often said to be a generalized creditor right. Suppose \( D \text{ Corp.} \) is 100 percent owned by one or more shareholders (whom we shall call \( SH \), if a human being, or \( P \text{ Corp.} \) for “parent corporation” if \( P \text{ Corp.} \) is an artificial being). It is said that \( T \) has the right to pierce the veil between \( D \text{ Corp.} \) and \( SH \) or \( P \text{ Corp.} \). The \( C_g \) do not have standing to pursue a piercing right, because piercing is supposedly a generalized creditor right. Yet this does not successfully describe why \( T \) predominates. Piercing the corporate veil is not a creditor right at all! “Alter ego”\(^{22}\) or piercing is not a “cause of action.” Piercing the veil is simply a legal fact in the world. We all know that Clark Kent is really Superman. Superman owns the Fortress of Solitude. Ergo Kent owns the Fortress of Solitude. If Kent is bankrupt, the Fortress of Solitude is property of the bankruptcy estate. Any \( C_i \) that attempts to docket a judgment in the jurisdiction where the Fortress of Solitude is located is in violation of the Bankruptcy Code’s automatic stay. Similarly, when \( D \text{ Corp.} \) is bankrupt and the shareholder \( SH \) is the same person (because of veil piercing), the \( C_g \) are barred by the automatic stay from pursuing \( SH \)’s property, because \( SH \)’s property is part of the bankruptcy estate.

The \textit{Purdue} plan, as written, with its channeling injunction, was confirmable because the bankruptcy estate owned looting claims and accompanying breach of fiduciary duty claims, because the bankruptcy estate owned the fraudulent transfer claims, and because only \( T \) has the right to third-party property as implied by veil piercing. No creditor rights (other than fraudulent transfer rights) were implicated in the channeling injunction (as properly interpreted).

This does not terminate our examination of the unified theory, however.

\(^{22}\)Critics don’t like the phrase alter ego. \textit{Stephen M. Bainbridge \& M. Todd Henderson, Limited Liability: A Legal and Economic Analysis} 130 (2016); \textit{Lee C. Hodges \& Andrew B. Sachs, Piercing the Mist: Bringing the Thompson Study into the 1990’s}, 43 WAKE FOREST L. REV. 341, 342 (2006); \textit{David Milon, The Still Elusive Quest to Make Sense of Veil-Piercing}, 89 TEX. L. REV. 15, 20 (2009); \textit{Peter B. Oh, Veil Piercing Unbound}, 93 B.U. L. REV. 89, 90-91 (2013). We argue that the term “alter ego” can be a vivid short-hand term for a court’s conclusion that true piercing is appropriate. Some courts use alter ego and piercing analysis interchangeably, but others either that alter ego is one of a number of grounds for piercing or an alternate to piercing. See infra text accompanying notes 180-82.
Parts V and VI investigate the generalized/particularized dichotomy in the context of mass tort bankruptcies. Part V discusses successor liability, where tort victims (Cv) who are a proper subset of Cg (Cv \subseteq Cg), have a property interest in the factory that produced the defective products. Courts have incorrectly identified the Cv as having a generalized right, thereby depriving them of a valuable priority to D Corp.'s factory. Part V concludes with an examination of the obligation of an insurer to reimburse D Corp. for tort claims the victims (Cv \subseteq Cg) have against D Corp. Cv's right to insurance proceeds is portrayed as a generalized creditor or derivative right. In fact, the Cv are secured creditors in the bankruptcy. The insurance policy is their collateral. The generalized/particularized dichotomy is useless in assessing the rights of the Cv.

I. CORPORATE LOOTING

Our first category is theft or embezzlement. Suppose D Corp. has a gold brick as its only asset. The treasurer X simply takes the brick without authority and buries it in his back yard. D Corp. still holds title to the brick. At its option, D Corp. may replevy the brick. In replevin, a writ is issued commanding the sheriff to dispossess X and put D Corp. back in possession. Alternatively, at D Corp.'s option, D Corp. may sue X for the tort of conversion. In that case, D Corp. admits that X is the owner of the brick but X is obliged to pay the value of it. A conversion theory culminates in a money judgment, which entitles D Corp. to execute on any nonexempt property of X (including the gold brick, which D Corp. admits X owns).

In Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.), the court suggested that when X steals from D Corp., the Cg have rights under state law to sue X for damages:

\[ \text{Often there are claims against third parties that wrong-} \]
\[ \text{fully deplete the debtor's assets. Individual creditors may} \]
\[ \text{wish to bring claims against those third parties to seek com-} \]
\[ \text{pensation for harms done to them by the debtor and sec-} \]
\[ \text{ondary harms done to them by the third parties in wrongfully} \]
\[ \text{diverting assets of the debtor that would be used to pay the} \]
\[ \text{claims of the individual creditor. The fact that an individual} \]
\[ \text{creditor may seek to do so does not make those secondary} \]
\[ \text{claims particular to the creditor, for it overlooks the obvious:} \]

\[ \text{Wyatt v. Cole, 504 U.S. 158 (1992).} \]
\[ \text{Pierpoint v. Hoyts, 182 N.E. 235 (N.Y. 1932) (stock certificates); Cooper v. Shepherd, 3 CB 266, 136} \]
\[ \text{ER 107 (CP) (1846); RESTATEMENT (SECOND) OF TORTS § 222A (Am. L. Inst. 1998) (defining conver-} \]
\[ \text{|sion as an "intentional exercise of dominion or control over a chattel . . . ".}} \]
\[ 855 F.3d 84 (2d Cir. 2017). \]
Every creditor has a similar claim for the diversion of assets of the debtor's estate. Those claims are general—they are not tied to the harm done to the creditor by the debtor, but rather are based on an injury to the debtor's estate that a creates a secondary harm to all creditors regardless of the nature of their underlying claim against the debtor.  

This remark is actually offered in the context of successor liability, not in an embezzlement case. In the successor liability context the remark is inappropriate. But as applied to embezzlement, the remark is especially inappropriate. The C's have no property interest in the stolen brick. X has no duty to the creditors of D Corp. to refrain from stealing. The "generalized creditor right" described by the Second Circuit simply does not exist. D Corp. has the right to the gold brick or its value; the C's do not.

Interpreting Tronox, the court in Continental Casualty Co. v. Carr (In re W.R. Grace & Co.) put it this way:

Tronox thus aptly sets forth the legal differences between a derivative claim and a nonderivative claim. A derivative claim, thus, is a general claim which can be brought by the debtor (or a trustee on behalf of all the debtor's creditors).

This too is taken out of the context of theft. The Grace court was considering "piercing a corporate veil," a theory usually thought to belong to T but one which, in the absence of bankruptcy, C might exploit. But, as applied to embezzlements, the statement is wrong. If X steals a gold brick from D Corp., C cannot sue X. C has no property interest in the brick.

On the other hand, once C has a judgment against D Corp., C can levy on D Corp.'s assets, including the brick and including the cause of action against X sounding in conversion. If C serves an execution on the sheriff, the sheriff can simply take the brick on behalf of C, as X has no appreciable property in it. D Corp. owns the brick, and the execution authorizes the sheriff to levy D Corp.'s property in satisfaction of the money judgment that C has against D Corp. Or, if C goes the conversion route, X's tort liability to D Corp. would be litigated in a garnishment proceeding against X.

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26Id. at 103-04 (footnote omitted).
27See infra text accompanying notes 268-322.
28Hamid v. Price Waterhouse, 51 F.3d 1411, 1419 (9th Cir. 1995) ("Can a depositor in a bank sue a bank robber?")
31Id.
32E.g., N.Y.C.P.L.R. § 5232(b).
33Id. § 5227.
Here, \( C_1 \)'s right is truly derivative. \( C_1 \) has no claim against \( X \), but \( D \text{ Corp.} \) does, and \( C_1 \) is entitled to take over \( D \text{ Corp.} \)'s property, once \( C_1 \) has a money judgment against \( D \text{ Corp.} \). If \( D \text{ Corp.} \) is bankrupt, \( T \) succeeds to \( D \text{ Corp.} \)'s title and to the related causes of action.\(^{34} \) \( T \) does not "take over" anything from the \( C_g \). In theft cases, no generalized creditor right exists. Meanwhile, \( C_1 \) is barred by the automatic stay from levying on property of the bankruptcy estate.\(^{35} \) \( T \) may recover the brick from \( X \) or sue in conversion. \( C_1 \) may not.

What happens when \( T \) never pursues \( X \) for the stolen brick? If the brick was scheduled by \( D \text{ Corp.} \) as an asset, \( T \) may choose to abandon it.\(^{36} \) In that case, the brick has been administered. The bankruptcy case is closed. The property reverts back to \( D \text{ Corp.} \). Since corporations are not eligible for bankruptcy discharge,\(^{37} \) \( C_1 \) may, when the automatic stay ends, garnish \( X \) for the brick or for the conversion action based on \( C_1 \)'s prepetition judgment against \( D \text{ Corp.} \). If, however, \( D \text{ Corp.} \) never scheduled the brick as an asset, the brick has not been administered.\(^{38} \) Upon learning of the brick, \( T \) may reopen the case\(^{39} \) and make \( C_1 \) account for having levied upon property of the estate.

Thefts are often confused with fraudulent transfer theories. Fraudulent transfer theories do indeed belong to creditors and \( T \) succeeds to these. But where we have a theft and not a fraudulent transfer, there is no need to refer to creditor rights at all.

This principle was anciently established in \( Park \) v. \( Cameron \), a cryptic Holmes opinion if there ever was one.\(^{40} \) In 1915, federal courts had jurisdiction over fraudulent transfer suits because these suits involved a federal question; the bankruptcy trustee brought suit under the Bankruptcy Act of 1898. But a conversion cause of action arises under state law. Federal jurisdiction in 1915 would have required diversity of citizenship, if the cause of action sounded in theft.

In \( Park \), insiders of insolvent \( D \text{ Corp.} \), without authority of the board of directors, caused the treasurer of \( D \text{ Corp.} \) to issue a check to \( X \) in exchange for worthless shares in \( D \text{ Corp.} \). \( D \text{ Corp.} \)'s bankruptcy trustee (\( T \)) brought a fraudulent transfer suit. The federal courts had jurisdiction over such suits, because they fell under the Bankruptcy Act and hence under the court's "federal question" jurisdiction. \( X \) challenged jurisdiction; the transfer was not a

\(^{34} \) 11 U.S.C. § 541(a)(1).
\(^{35} \) Id. § 362(a)(2).
\(^{36} \) Id. § 554(a) ("After notice and a hearing, the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.").
\(^{37} \) Id. § 726(a)(1).
\(^{38} \) Id. § 554(d) ("Unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate").
\(^{39} \) Id. § 350(b).
\(^{40} \) 237 U.S. 626 (1915).
fraudulent transfer. It was a theft by the insiders and X was a transferee of stolen property under state law; hence, in the absence of diversity of citizenship, the federal courts had no jurisdiction. The Supreme Court ruled against jurisdiction. Corporate looting cases are not fraudulent transfer cases. Fraudulent transfer rights are creditor rights but conversion actions are not creditor rights at all. But, as we shall soon see, not even fraudulent transfer theories are generalized creditor rights. Sometimes proper subsets of the Cg have fraudulent transfer rights whereas the Cg in general do not.

II. CONSTRUCTIVE TRUST

Suppose D Corp. owns a gold brick. In a theft, D Corp. never conveys title. D Corp. never transfers anything at all. But now suppose D Corp.'s board of directors authorizes a transfer of the brick to X. X has, however, defrauded the directors. D Corp. has the right to rescind the transfer and get back the brick. Meanwhile, pending the rescission, X has voidable title. X holds title for the benefit of D Corp. D Corp. has the equitable interest in the brick.

There are two differences between theft and the fraudulently induced transfer. First, theft does not convey title. A voidable transfer does. Second, in a theft, X has no power to convey free and clear of D Corp.'s title. If B, a bona fide purchaser for value, buys the stolen brick, D Corp. may still replevy the brick from B, or sue B for conversion. But if X is a constructive trustee rather than a thief, X has title and the power to convey D Corp.'s equitable title to B, if B is a good faith purchaser for value. In such a case, D Corp. has lost the equitable interest in the gold brick and therefore may not recover it from B. But D Corp. may sue X for converting D Corp.'s equitable title in the brick to his own use.

A third difference between theft and constructive trust is the status of the conversion cause of action. X's theft is wrongful interference per se. At D Corp.'s option, D Corp. may sue for a money judgment. X may not avoid the money judgment by tendering the brick. Once D Corp. sues for conversion, D Corp. has alienated the brick; it belongs to X.

If X has voidable title, however, X is in rightful possession. If D Corp. demands the brick and X tenders it, there has been no wrongful interference with D Corp.'s possessor right and no tort of conversion. If, on the other hand, X

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42 See infra text accompanying notes 60-65.

43 RESTATEMENT (3D) OF RESTITUTION AND UNJUST ENRICHMENT § 13 (Am. L. Inst. 2011).

hand, \( X \) refuses to give back the brick, then \( X \) has converted the brick to his own use and has committed the tort of conversion.\(^{45}\)

\( C_1 \) has no direct access to the gold brick if \( X \) is constructive trustee. But if \( C_1 \) obtained a money judgment against \( D \) \( \text{Corp.} \), \( C_1 \) may levy \( D \) \( \text{Corp.} \)’s equitable interest by bringing garnishment proceedings against \( X \). Constructive trust is therefore not a generalized creditor right. Rather, \( D \) \( \text{Corp.} \) is a property owner. \( D \) \( \text{Corp.} \) owns the equitable interest in the gold brick. \( C_1 \) has no direct property interest in the brick but may nevertheless garnish the brick after getting a money judgment against \( D \) \( \text{Corp.} \). If, however, \( D \) \( \text{Corp.} \) is bankrupt, \( T \) inherits \( D \) \( \text{Corp.} \)’s equitable interest in the brick. \( T \) takes nothing at all from \( C_1 \). \( C_1 \) is barred by the automatic stay from pursuing \( D \) \( \text{Corp.} \)’s property and therefore \( C_1 \) may not proceed against \( X \).

If \( T \) abandons \( D \) \( \text{Corp.} \)’s equitable interest in the brick, the equitable interest reverts back to \( D \) \( \text{Corp.} \). As with theft, \( C_1 \) can levy on the equitable interest by bringing garnishment proceedings against \( X \). But, where \( D \) \( \text{Corp.} \)’s equitable interest in the brick was never scheduled in the bankruptcy and where the case is closed, \( T \) may reopen the bankruptcy and make \( C_1 \) account for garnishing \( D \) \( \text{Corp.} \)’s equitable interest in the gold brick.

III. FRAUDULENT TRANSFERS

A. THE IN REM VERSION

In corporate looting cases, \( D \) \( \text{Corp.} \) never conveys title (unless \( D \) \( \text{Corp.} \) chooses to sue in conversion). In constructive trusts, \( D \) \( \text{Corp.} \) conveys legal title but retains equitable title. In a fraudulent transfer, \( D \) \( \text{Corp.} \) conveys both legal and equitable title in the brick to \( X \). \( D \) \( \text{Corp.} \) no longer has any interest in the brick.\(^{46}\)

If \( D \) \( \text{Corp.} \)’s motive was to hinder the \( C_g \) in executing on the brick, then \( X \) takes the brick for the benefit of the \( C_g \). In the language of Uniform Fraudulent Transfer Act (UFTA) § 4(a)(1):

\[
A \text{ transfer made } \ldots \text{ by a debtor is fraudulent as to a creditor} \ldots \text{ if the debtor made the transfer } \ldots \text{ (1) with actual intent to hinder, delay, or defraud any creditor of the debtor } \ldots
\]

Intent is presumed when \( D \) \( \text{Corp.} \) is insolvent and \( X \) has paid no reasonably equivalent value.\(^{47}\)

If \( D \) \( \text{Corp.} \)’s transfer is fraudulent, \( C_1 \) may avoid the transfer. Basically, this means that \( C_1 \) is entitled to a declaration by a court of equity that \( C_1 \) has a judicial lien on \( X \)’s brick to secure the judgment in \( C_1 \) v. \( X \).\(^{48}\)

\(^{45}\)Carlson, Worlds, supra note 21, at 373-74.

\(^{46}\)Carlson, Void and Voidable, supra note 15, at 30-36.

\(^{47}\)UNIF. FRAUDULENT TRANSFER ACT §§ 4(a)(2), 5.

\(^{48}\)Carlson, Void and Voidable, supra note 15, at 30-36.
The right of the Cg to the brick outside of bankruptcy is "first come first served." X holds the brick in trust for the Cg. When a specific C appears to assert the fraudulent transfer right, C obtains a judicial lien on X brick, even though D Corp. has absolutely no property interest in the brick. Suppose the sheriff levies X's brick in response to C's execution. X has performed the trust. When, another creditor, C arrives to make the same claim, X can say that X performed the trust by giving the brick over to C's sheriff. C has no further cause of action against X.

If D Corp. is bankrupt, however, T has a direct cause of action against the brick pursuant to Bankruptcy Code § 548(a). The brick becomes property of the bankruptcy estate. The automatic stay prevents any and all Cg from pursuing the brick in competition with T.

The Bankruptcy Code innovates on classic fraudulent transfer law. Not only is X liable as the initial transferee of the fraudulent transfer, but so are non-transferees, if the nontransferee is an "entity for whose benefit such transfer was made ..." The origin of this rule is convoluted. An example may serve to illustrate the liability of a nontransferee. Suppose D Corp. wishes to hinder its creditors by conveying away the brick, but X says, "Don't give the brick to me. Give it to my LLC, X Corp. D Corp. obliges, and X Corp. now owns legal title to the brick but holds the brick in trust for T. X Corp. is the initial transferee of the brick and X is not a transferee. Shareholders are separate persons from the corporation that issued them the shares. Nevertheless, X benefited by the transfer. Therefore X is "the entity for whose benefit such transfer was made."

Because X is a nontransferee, X probably cannot be made to fork over the brick. The brick does not belong to X. It belongs to X Corp., a separate person. Accordingly, T is pretty much limited to a money judgment for the value of the brick. Bankruptcy Code § 550(a) indeed provides the "the trustee may recover, for the benefit of the estate, [the brick], or, if the court so orders the value of such property ..." Value of such property invites the court to issue a money judgment against the benefited entity X.

The benefited entity innovation means that fraudulent transfer law is no longer purely an in rem theory. Fraudulent transfer has (possibly) become a tort, if we define "tort" as a historical event justifying a money judgment against the defendant. Therefore, we will soon replay the fraudulent transfer

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49 Carlson, Tort, supra note 15.
53 See Carlson, Mere Conduit, supra note 20, at 493-96.
script focusing solely on money judgment as the remedy for fraudulent transfer.

We are not, however, done with the in rem theory. So far we have mentioned T’s direct in rem right to the brick as embodied in § 548(a). Section 548(a), however, has an extremely short statute of limitations—the transfer must have been made within two years of the bankruptcy petition. Prior to 2005, the statute of limitations was even shorter—one year.

In a great many cases, the fraudulent transfer is older than two years. It is an important datum that the trustee is subrogated to C₁’s avoidance rights under state law. State law usually has a longer statute of limitations. Under the UVTA or UFTA, the limitation period is at least four years.

According to Bankruptcy Code § 544(b)(1),

the trustee may avoid a transfer of an interest of the debtor in property . . . that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

This provision requires T to identify a “triggering creditor”—a real live creditor with avoidance rights under state law.

Section 544(b)(1) is extremely limited. It refers only to the avoidance of a transfer. And it requires the triggering creditor to have an “allowable” unsecured claim against D Corp. Suppose, prior to D Corp.’s bankruptcy, C₁ has commenced fraudulent transfer litigation against X, the initial transferee of the gold brick. Commencement of the litigation classically brought the brick in custodia legis which resulted in C₁’s priority to the brick. When D Corp. files for bankruptcy, C₁ is a secured creditor in D Corp.’s bankruptcy, by virtue of the prepetition equity lien on the brick. Is T too late? No. T still gets the brick as unencumbered by C₁’s lien. If § 548(a) applies, T can show X is the initial transferee, C₁ is the transferee of a transferee. That is, the D Corp.-X transfer of the brick was the initial transfer. The creation of C₁’s lien is the secondary transfer. Thus, C₁’s lien can be undone and C₁ enters the bankruptcy unsecured.

If § 548(a) does not apply, then T is not subrogated to C₁’s avoidance.

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55Id. § 548(a)(1).
56UNIF. FRAUDULENT TRANSFER ACT § 9, UNIFORM VOIDABLE TRANSFER ACT § 9.
59Cassady v. Anderson, 53 Tex. 527, 537 (1880) ("As between two creditors, if one has already obtained his judgment and instituted proceedings to set aside the fraudulent conveyance, this will give him priority of right to first have his debt satisfied out of the property . . . ").
60Carlson, Void and Voidable, supra note 15, at 21-25.
right since \( C_1 \) is ( provisionally ) a secured creditor and \( T \) needs an unsecured \( C_2 \) to be the triggering creditor. If \( C_2 \) exists, then the trustee can assert \( C_2 \)'s right to the brick. \( X \) is again the initial transferee, \( C_1 \) the transferee of a transferee. \( C_1 \) loses the lien that existed at state law.

Section 544(b) suggests that if the \( C_g \) have avoidance rights, \( T \) supervenes and takes them over. Thus, none of the \( C_g \) can maintain a state-law cause of action for fraudulent transfer avoidance. But suppose \( T \) abandons the fraudulent transfer theory. The cause of action then reverts back to the \( C_g \) and any one of them can pursue the brick on a first-come-first served basis. Legal title to the brick reverts back to \( X \).

Because of § 548(a) and § 544(b), there is absolutely no need for the doctrine of generalized creditor rights. This is a good thing. Fraudulent transfer is not a generalized creditor right. The UFTA limits recoveries to subsets of the \( C_g \). The appearance of a proper subset means that fraudulent transfer theory is a particularized creditor right. And yet, at least so far as the in rem right in the fraudulently transferred thing is concerned, \( T \) is subrogated to the \( C_g \), so long as the triggering creditor can be identified. This proves the generalized v. particularized distinction misdescribes the basic assignment of power between \( T \) and the \( C_g \) in the context of fraudulent transfers.

How might proper subsets of the \( C_g \) arise? First, the UFTA distinguishes between present and future creditors. Both present and future creditors may bring actions for actual intentional frauds. Both present and future creditors may bring constructive fraudulent transfer actions where the “insolvency” predicate is “unreasonably small” capital or intent “to incur . . . debts beyond his [or her] ability to pay.” But present creditors only may bring actions under UFTA § 5. These include “classic” constructive fraudulent transfers—transfers for no reasonably equivalent value. Thus, fraudulent transfers are at least sometimes particularized creditor rights.

Second, a subset of the \( C_g \) may result from the UFTA’s statute of limitations. Constructive fraudulent transfers are subject to a straight four-year limit after the transfer was made. But actual fraudulent transfers are sub-

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63Id. § 4(a)(2)(i).
64Id. § 4(a)(2)(ii).
65Id. § 5(a) (“A transfer made . . . by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made . . . if the debtor made the transfer . . . without receiving a reasonably equivalent value in exchange for the transfer . . . and the debtor was insolvent at the time or the debtor became insolvent as a result of the transfer”).
66Id. § 9(b).
ject to a “discovery” rule.\textsuperscript{67} Thus, we could imagine a scenario whereby \( D \text{ Corp.} \)'s fraudulent transfer of the gold brick to \( X \) was an actual fraud. The \( C_g \) minus \( C_1 \) might all be aware of the fraudulent nature of the transfer because they were all insider creditors with lots of knowledge of \( D \text{ Corp.} \)'s affairs. \( C_1 \), however, may have had no such knowledge. If so, then \( C_1 \)'s right would still be alive, even as the other \( C_g \) rights have expired. \( C_1 \)'s right would then be a particularized creditor right. Alternatively, \( C_1 \) might be the federal government, in which case federal law gives \( C_1 \) a six year statute of limitations.\textsuperscript{68} We have produced a proper subset of the \( C_g \), thereby proving that fraudulent

\textsuperscript{67}Id. § 9(a) ("under Section 4(a)(1), within 4 years after the transfer was made ... or, if later, within one year after the transfer ... was or could reasonably have been discovered by the claimant").

\textsuperscript{68}This situation arose in the landmark case of Tronox Inc. v. Kerr McGee Corp. (In re Tronox Inc.), 503 B.R. 239 (Bankr. S.D.N.Y. 2013). \( D \text{ Corp.} \) operated a chemical business and it owned subsidiaries that conducted oil and gas "exploration and production" (E&P) businesses. \( D \text{ Corp.} \) had crushing environmental obligations. It sought to separate the E&P business from its chemical business through a spinoff which was found to be a fraudulent transfer.

Things fared poorly for \( D \text{ Corp.} \), which filed for bankruptcy on January 12, 2009. \( D \text{ Corp.} \) obtained confirmation of a plan, which allocated its fraudulent transfer actions to a postconfirmation trust. The beneficiaries of the trust were environmental claimants, including the EPA, which sought reimbursement for superfund cleanup. These creditors had traded their right to a distribution from the plan for their interest in the trust. \textit{Id.} at 262-63. The trust brought suit against \( X \text{ Corp.} \) for fraudulent transfers by \( D \text{ Corp.} \) to \( X \text{ Corp.} \).

A formidable stumbling block to the plaintiff was the statute of limitations. Since bankruptcy occurred on January 12, 2009, use of § 548(a), with a two-year look-back period, was out of the question. (The latest part of the fraudulent transfer scheme was the March 31, 2006, spinoff.) The only alternative was subrogation to a triggering creditor under § 544(b). The court offered a reason why the statute of limitations was no impediment. One of the creditors was the Environmental Protection Agency, seeking superfund compensation from \( D \text{ Corp.} \). The United States has its own fraudulent transfer rights in the Federal Debt Collection Procedure Act (FDCPA). This Act, dating from 1990, P.L. 101-647, 104 Stat. 4961 (1990), repeats a version of the UFTA for the benefit of the United States as a creditor. 28 U.S.C. § 3304. The FDCPA gives the United States a six-year statute of limitation. 28 U.S.C. § 3306(b)(1) & (2). See generally R. Stephen McNeill, Avoiding the Unavoidable: A Practitioner's Guide to Federal Government Creditor Fraudulent Conveyance Actions, 92 AM. BANKR. L.J. 335 (2018). Accordingly, the United States could have brought a suit any time before January 1, 2008. Standing alone, this was not good enough for the plaintiff, which could subrogate to the rights of the United States. The United States, however, had entered into a tolling agreement with \( D \text{ Corp.} \). 503 B.R. at 277-28. Therefore, on May 12, 2009, when the plaintiff filed suit, the claim of the United States was still alive. 503 B.R. at 272.

In so finding, the court disagreed with MC Asset Recovery LLC v. Commerzbank A.G. (In re Mirant Corp), 675 F.3d 530 (5th Cir. 2012), which held that the FDCPA, by its own terms, can never supply the choice of law in a § 544(b) action. According to FDCPA § 3003(c), "This chapter shall not be construed to supersede or modify the operation of—(1) title 11. § 28 USC 3003(c). The court cited and followed the comment of Congressman Jack Brooks "This provision was carefully worded to make clear that the act would have absolutely no effect on the Bankruptcy Code, even provisions of the Bankruptcy Code making reference to nonbankruptcy law are to be read as if this act did not exist." 136 Cong. Rev. H13288 (daily ed. Oct. 27, 2990). Said the \textit{Tronox} court, "Treating the FDCPA as 'applicable law' does not 'modify' or 'supersede' the operation of the Bankruptcy Code, and a holding that the Code 'should be read as if the FDCPA did not exist' give too much weight to a comment in the legislative history," 503 B.R. at 273. See also United States v. Nemecek, 79 F. Supp. 2d 821, 825-27 (N.D. Ohio 1999) (United States avoidance right cannot be limited by UPTA).
transfer avoidance is a particularized creditor right. Nevertheless, \( T \) predominates so long as \( T \) can locate a single triggering creditor.

Our task is to show that the general v. particular distinction is incompetent to describe the rules of standing. Fraudulent transfer avoidance has to be counted as a particularized creditor right and yet \( T \) still has standing. Bankruptcy law is still quite coherent without the generalized/particularized dichotomy.

B. The In Personam Version

A confusing issue is whether fraudulent transfer law has become a tort, in the sense that \( C \) is absolutely entitled to a money judgment. In cases of theft, \( D \) Corp. is entitled to a money judgment against \( X \) because conversion is a tort—an in personam theory. Is the same true for \( C \) when \( D \) Corp. fraudulently transfers property to \( X \)?

Classically, fraudulent transfer was an in rem theory. It gave the \( C \) an equitable interest in \( X \)'s brick. \( C \)'s remedy was to disregard the conveyance and simply levy the brick (the legal remedy), or to avoid the transfer in a creditor's bill in equity. Equity would declare a fraudulent transfer void and implied a lien for \( C \) at the commencement of the action. \( C \) was not entitled to a money judgment in lieu of getting a lien on the brick. But equity was prepared to give a money judgment if \( X \) was at fault in not maintaining the brick in pristine shape so that a judicial lien might attach to it. \( X \)'s fault was key in this.\(^69\)

In this vision, \( D \) Corp.'s fraudulent transfer was not a "wrong." In the classic case of Adler v. Fenton,\(^70\) \( D \) had conveyed property to \( X \) ostensibly to pay an antecedent debt. According to the syllabus of the case,\(^71\) \( C \) alleged that \( D \) and \( X \) "had combined and conspired . . . to dispose of [\( D \)'s] property fraudulently, so as to hinder and defeat [\( D \)'s] creditors in the collection of their lawful demands."\(^72\) The claim seemed to be that \( X \) had aided \( D \) in impoverishing himself and that \( C \) was damaged in being unable to collect \( C \)'s claim. In \( C \)'s theory, the fact that \( X \) was the recipient was not the point. The unmeritorious claim was that \( X \) had a duty to \( D \)'s creditors to preserve \( D \)'s estate so that, after judgment against \( D \), \( C \) could collect without impediment via execution.\(^73\) The Supreme Court ruled that no such duty existed. It in-

\(^{69}\)Frederick S. Wait, A Treatise on Fraudulent Conveyances and Creditors' Bills § 51 (3d ed. 1897).

\(^{70}\)65 U.S. 407 (1861). \( C \)'s claim "was not yet due at the time of bringing the action," according to the syllabus accompanying the opinion. Id. at 408.

\(^{71}\)Technically, reference to the syllabus is illegitimate, because the syllabus of a case is not part of the Supreme Court's opinion. United States v. Detroit Timber & Lumber Co., 200 U.S. 321, 337 (1906). Suspending this rule helps to understand the actual facts of the case.

\(^{72}\)Adler, 65 U.S. at 408.

\(^{73}\)The Adler court distinguishes the cases where \( C \) has a lien on \( D \)'s property and \( X \) interferes with it.
situated that $D$ had a right to alienate the property, and that $X$ (the recipient) had conspired with $D$ to do a legal act. "To enable the plaintiffs to sustain an action on the case like the present, it must be shown that the defendants have done something wrong, that is, have violated some right of theirs." 74 Conspiracy to do injurious acts without violating some right of $C$ was not actionable. 75

A fraudulent transfer did not make $D$ Corp. more liable to $C_1$ than the $C_1 - D$ Corp. judgment already established. Since $D$ Corp. had the right to transfer its property—even fraudulently—$X$ was not in the wrong for receiving the fraudulent transfer. Rather, $X$ was simply the fiduciary of the brick for the benefit of the $C_2$. If $X$ "performed the trust" by making the property available to one of the $C_2$, $X$ had no further liability.

But state courts started to re-think the matter. According to a minority of states, $D$ Corp. was wrong to convey the brick—at least where $D$ Corp. actually (not constructively) transferred the brick to $X$ and where $X$ was aware of this. 76 Since $D$ Corp. was a tortfeasor, any coconspirator in the wrong was likewise liable for the tort. Thus, not only was $D$ Corp. doubly liable, but $X$ was liable because receipt was part of the conspiracy. And not only $X$. A, the attorney who drafted the deed of gift, was liable. M (the messenger with guilty knowledge) who delivered the brick might liable. Anyone who was part of the transaction could be liable. This is commonly, if somewhat inaccurately, called "aiding and abetting" a fraudulent transfer. 77

Where this is the concept, $C_1$ has the right to a money judgment against $X$, A and the other conspirators. Presumably, we would like to think that

Thus, it cites Yates v. Joyce, 11 Johns. 136 (N.Y. 1814), where $C$ had a judicial lien on $D$'s house. $X$ trashed the house, thereby harming $C$'s lien, and for this $X$ owed money damages.

74 Adler, 65 U.S. at 409. Per Chancellor Kent, "The reason of the rule seems to be that until the creditor has established his title [with a judgment] he has no right to interfere, and it would lead to an unnecessary and, perhaps, a fruitless and oppressive interruption of the exercise of the debtor's rights. Unless he has a certain claim upon the property of the debtor, he has no concern with his frauds." Wiggins v. Armstrong, 2 Johns. 135 (N.Y.) (1816). See also Van Royen v. Lacey, 277 A.2d 13, 15 (Md. App. 1971); E.J. Klous & Co v. Hennessey, 13 R.I. 332 (1881); cf. Whitman v. Spencer, 2 R.I. 124 (1852) (jury could hear law action by $C$ against $X$).

75 $C$ might have made a constructive trust claim because $D$ defrauded $C$ of goods. But $C$ destroyed this option by suing for the price of the goods, which is based on both legal and equitable title being in $D$. Adler, 65 U.S. at 411.


77 Gierum v. Glick (In re Glick), 568 B.R. 634, 676 (Bankr. N.D. Ill. 2017). Conspiracy is an agreement to commit a wrong plus an overt act in furtherance of agreement — it is a theory of primary liability that is separate from the wrong itself and, like attempt, can impose liability even if the wrong is not committed. In contrast, aiding and abetting is knowingly giving substantial assistance to a wrong committed by another and is a theory of secondary liability. In our example, the driver would probably be an aider and abettor, but not a conspirator.
when $C_1$ obtained a money judgment against $X$, $X$ has bought the brick and has good title against $C_2$. But this refinement has not yet been worked out. Also unknown are the bankruptcy implications of this relatively new tort theory. Under § 548(a), $T$ may avoid transfers. There is no provision for money judgments against aiders and abettors. It seems safe to say that under § 548(a), the trustee is not entitled to a judgment against $A$, the attorney who drafted the fraudulent gift, unless a court is willing to say that the attorney was an entity benefited by the transfer to $X$.78

If the trustee relies on subrogation under § 544(b)(1), it is not clear that the trustee is subrogated to tort claims. Section 544(b) speaks of avoiding transfers, not suing aiders and abettors. What gets added to the bankruptcy estate is the fraudulently transferred thing, not a cause of action against aiders and abettors. This belongs to the $C_e$ alone. One way to smooth over this point is to maintain that aiding and abetting a fraudulent transfer is a generalized creditor right.79 But § 544(b)(1) is seemingly the only vehicle by which fraudulent transfer rights pass from the $C_e$ to $T$. Section 544(b)(1) assumes that fraudulent transfer theory is an in rem right. It does not indicate that $C'$s in personam right against a conspirator passes to the trustee. Some courts have so held.80 If so, the tort claim remains $C$'s property. Even though $D$ is bankrupt, $C$ can still sue $X$ personally because $C$ is not pursuing $X$'s gold brick. That belongs to $D$'s bankruptcy trustee. $C$ is suing $X$ for damages, and that theory belongs to $C$ alone.81

Two commentators, Richard J. Mason and Patricia K. Smoots, have argued that a trustee can pursue fraudulent transfer torts under the strong-arm power.82 According to Bankruptcy Code § 544(a):


The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists... 83

Mason and Smoots assert that, under the “plain meaning” (their words) of § 544(a)(1), a trustee is subrogated to a “general” creditor tort claim but not a “specific” creditor tort claim (the “Mason Smoots conjecture”).84 The idea is an unusual application of the strong-arm power. Typically, when T invokes the strong-arm power, T relies on a hypothetical judicial lien, not on the hypothetical provision of credit. When D Corp. grants an unperfected security interest to SP and then files for bankruptcy, T “subordinates” SP to her judicial lien.85 Yet provision of credit is to be hypothesized just as much as the judgment and the accompanying judicial lien.86

The theory depends on aiding and abetting a fraudulent transfer being a generalized creditor right. We think that since fraudulent transfer rights are particularized, torts based on the right to avoid a transfer are also particularized. Therefore, the Mason-Smoots conjecture does not quite work.

In Marshall v. Picard (In re Bernard L. Madoff Inv. Secs. LLC) (Madoff I),87 the court insinuated that T was subrogated to aiding and abetting claims connected with fraudulent transfers. The case involved a Ponzi scheme,

85U.C.C. 9-317(a)(2).
86Koch Refining v. Farmers Union Central Exchange, Inc., 831 F.2d 1339, 1348 (7th Cir. 1987) (“[T] has creditor status under section 544 to bring suits for the benefit of the estate and ultimately of the creditors.”).
87740 F.3d 81 (2d Cir. 2012).
which are properly analyzed as constructive trust cases.\textsuperscript{88} Madoff, however, is a stockbroker liquidation and therefore governed by the Securities Investors Protection Act (SIPA). In such a case, a victim ($V$) has been fraudulently induced to invest funds with the broker. What $V$ entrusted to the broker is "customer property."\textsuperscript{89} Customer property must be distributed to customers only.\textsuperscript{90} According to SIPA § 78fff-2(c)(3), however:

> Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1), the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property and to the extent that such transfer if voidable or void under the Bankruptcy Code. Such recovered property shall be treated as customer property. \textit{For purposes of such recovery, the property so transferred shall be deemed to have been the property of the debtor and, if such transfer was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding.}\textsuperscript{92}

Thus, without SIPA, the $V$ would have equitable interests in the broker assets. $V$ alone could pursue trust assets that the broker has distributed to third parties. $T$ has no theory to pursue $V$'s equitable interest in trust property. But SIPA \textit{deems} the broker to own the equitable interest in customer property, and it authorizes the trustee to recover transfers as if fraudulent transfer really applies, reserving the proceeds for the investors. Therefore, it is appropriate to treat \textit{Madoff} as a fraudulent transfer case.

In \textit{Madoff I}, $T$ sued $X$ for billions. $X$ was a net winner from the Ponzi scheme. That is, $X$ was one of the investors lucky enough to withdraw her original investment and more before the scheme's collapse. $X$ settled for $6.7$ billion in exchange for a "channelling injunction" prohibiting any $C_g$ from bringing a "derivative" claim against $X$.\textsuperscript{93}

$C_1$ was also a net winner, but less spectacularly so than $X$. $C_1$ had been cheated of paper gains and sought to recover from $X$ on a tort theory that $X$ knew or should have known of the fraud. $C_1$'s law suit was held barred by

\textsuperscript{88}Carlton, Worlds, supra note 21.

\textsuperscript{89}The term 'customer property' means cash and securities ... held by or for account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted . . . “ 15 U.S.C. § 78iii(4).

\textsuperscript{90}Id. § 78fff-2(c)(1).

\textsuperscript{91}These include customer claims and subrogees (such as the Securities Investor Protection Corp.) of customer claims.


\textsuperscript{93}740 F.3d at 86-87.
the channelling injunction. X had not made particularized misrepresentations to C₁, as apart from the Cᵣ collectively.

C₁ claimed unique damages. C₁ had, for instance, paid taxes on fictitious gains and suffered a loss of reasonable return on their investment, plus the expense expected to be incurred when C₁ were sued by T for being net winners, "none of which is recoverable in an avoidance action under the Bankruptcy Code." The court held that the channelling injunction applied to prevent C₁ from making tort claims against X. These damages were merely "secondary harms flowing from [X]'s fraudulent withdrawals." As such they could be ignored for reasons the court neglected to explain. The court did not argue for this result but simply announced it.

Aider-abettor liability for fraudulent transfers is a new theory followed only in a minority of states, and it wreaks havoc with the system of avoiding fraudulent transfers in bankruptcy. Suppose it is decided that only a subset of Cᵣ can bring tort actions and therefore the trustee is not subrogated to this cause of action. If so, the tort theory profoundly affects T’s ability to settle with X, the recipient of a fraudulent transfer. If T owns the in rem right and the Cᵣ own the in personam right, T cannot guarantee X a global settlement.

A major case holding that T does not subrogate to aider-abettor liability is Picard v. JPMorgan Chase Bank & Co. (In re Bernard L. Madoff Inv. Sec. LLC) (Madoff II). But it does not really speak to the Mason-Smoots conjecture. Nevertheless, the case is not about aiding and abetting a fraudulent transfer. It is about aiding and abetting a scheme to get the Cᵣ to part with their money.

In Madoff II, D Corp. had a banking relationship with B Bank. B Bank maintained a deposit account for D Corp., and into this account invested funds came in and “lulling payments” went out. The fraudulent transfer portion of the case involved net winners. But T was attempting to represent the net losers against B Bank in aiding and abetting the fraudulent edifice that drew the victims into the web. As to these claims T had no standing. The harm was particularized in that each victim was separately induced to invest.

In short, the theory that fraudulent transfers are torts is deeply disturbing. The trustee is not clearly subrogated to the tort claims of the Cᵣ, and

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94Id. at 94.
95Id.
96721 F.3d 54 (2nd Cir. 2013).
97Cᵣ stands for the subset of D Corp. creditors who “victimized” by D Corp.'s fraud. Thus the Cᵣ\Cᵣ are the contract creditors who were not defrauded. (In set theory notation, \ means subtraction.)
98In Ponzi argot, “lulling payments” are payments to investors in order to give the appearance that all is normal. McHale v. Boulder Capital LLC (In re The 1031 Tax Group, LLC), 439 B.R. 47, 72 (Bankr. S.D.N.Y. 2010).
this directly undercuts T's ability to settle with X, the recipient of fraudu-
lently transferred property.

C. Breach of Fiduciary Duty for All of the Above

Suppose D Corp. has been the victim of a theft, or has been defrauded and has an equitable interest in a constructive trust, or has made a fraudulent transfer (because the board of directors ratified a transfer out of the ordinary course of business). Suppose that each one of these events might have been avoided if the directors and officers of D Corp. were vigilant. Under corporate law, D Corp. has a cause of action against the officers and directors for breach of fiduciary duty to the corporation.

Where the directors refuse to bring these lawsuits, shareholders are sometimes authorized to bring shareholder derivative actions. In such litigation, the shareholders are allowed under some circumstances to seize control of D Corp.'s cause of action against the directors and officers. That is, they are not suing in their own right, but to vindicate the rights of the corporation.

When D Corp. is insolvent (but not yet bankrupt), the standing as to who has may bring such an action shifts from the shareholders to the creditors. That is, C₁, as the residual claimant, can do what the shareholders could have done before insolvency - bring a derivative action on behalf of the corporation. But this would not enrich C₁ individually, as when C₁ pursues

98See, e.g., N.Y. Bus. Corp. Law § 720:

(a) An action may be brought against one or more directors or officers of a corpora-
tion to procure a judgment for the following relief:

(1) Subject to any provision of the certificate of incorporation authorized pursuant to paragraph (b) of section 402, to compel the defendant to account for his official conduct in the following cases:

(A) The neglect of, or failure to perform, or other violation of his duties in the management and disposition of corporate assets committed to his charge.

(B) The acquisition by himself, transfer to others, loss or waste of corporate assets due to any neglect of, or failure to perform, or other violation of his duties.

(C) In the case of directors or officers of a benefit corporation organized under article seventeen of this chapter: (i) the failure to pursue the general public benefit purpose of a benefit corporation or any specific public benefit set forth in its certificate of incorporation; (ii) the failure by a benefit corporation to deliver or post an annual report as required by section seventeen hundred eighty of article seventeen of this chapter; or (iii) the neglect of, or failure to perform, or other violation of his or her duties or standard of conduct under article seventeen of this chapter.

(2) To set aside an unlawful conveyance, assignment or transfer of corporate assets, where the transferee knew of its unlawfulness.

(3) To enjoin a proposed unlawful conveyance, assignment or transfer of corporate assets, where there is sufficient evidence that it will be made.

(b) An action may be brought for the relief provided in this section, . . . by a corporation, or a receiver, trustee in bankruptcy, officer, director or judgment credi-
fraudulent transfers. C, invokes a collective proceeding on behalf of D Corp.
The proceeds of these claims, if meritorious, are paid to D Corp., to be admin-
istered for the C, collectively. If anything is left, the shareholders get it.
Moreover, as the claim underlying a derivative action belongs to the corpora-
tion, its board of directors (hence T) always has the right to wrest it away
from C, 100

When the directors have approved a fraudulent transfer—transfer of a
gold brick—liability has a curious recursive loop. C, can pursue the brick and
may be paid out by doing so. What are the directors liable for? If D Corp. is
insolvent, they still work for the corporate entity as a whole, but now the
entity includes the C, as residual claimants. Yet one of their number actually
got the brick. Justice would be served best if C, were made to return the
brick to D Corp., so that all the C, could share in the glory of the brick. But
this violates the notion that a debtor cannot avoid her own fraudulent trans-
fer—only creditors can. 101 C, is invited by fraudulent transfer law to be
selfish and private. In a derivative action, the C, must act communistically.
Here, the C, may have commenced the derivative action for the corporation,
but the corporation has no right to the brick (when the brick was fraudu-
ently transferred).

Bankruptcy renders the scene more rational. T inherits D Corp.'s cause of
action for breach of fiduciary duty in all these cases. Thus, the trustee has all
the derivative rights. Should the C, try to bring a derivative action in the
postpetition period, that would violate Bankruptcy Code § 362(a)(3), which
prohibits third parties from controlling property of the bankruptcy estate. 102

For our purposes, T's standing to pursue D Corp.'s rights against the
directors for breach of fiduciary duty rests on § 541—the definition of prop-
erty of the bankruptcy estate. The generalized/particularized dichotomy is

100 The Delaware Supreme Court established the standard as to when the board may settle such a
101 Carlson, Worlds, supra note 21, at 436-37.

N.Y. Bus. Corp. Law § 720(a) and (b).

The Delaware Supreme Court has addressed what this means for creditors. Quadrant Structured
Gheewalla, 930 A.2d 92 (Del. 2007). In these cases, the Delaware Supreme Court attempted to redress a
WL 277613 at *42 & n. 55 (Del. Ch. 1991), by saying that fiduciary duties shift from the stockholders to
creditors during the zone of insolvency and implying that creditors might have a cause of action against
directors for prolonging the corporation's existence.
unnecessary and confusing. The right to pursue fraudulent transfers stems from either Bankruptcy Code § 548(a) and § 541(a)(3), or from § 544(b)(1) and § 541(a)(3). Once again, the generalized/particularized dichotomy is a superfluity.

IV. PIERCING THE CORPORATE VEIL

Suppose D Corp. has a 100 percent corporate shareholder, P Corp. P Corp. owns a gold brick. Maybe D Corp. conveyed the brick to P Corp.,103 maybe not. This makes all the difference in cases of theft or fraudulent transfer. Under such theories, D Corp. and P Corp. are separate persons. D Corp. is the transferor and P Corp. is the transferee.

Unlike those notions, the theory of “piercing the corporate veil” doesn’t care whether a transfer occurred. In our analysis, the term piercing should be limited to the assertion that D Corp. and P Corp. are the same entity.104 Therefore, D Corp. is the owner of the gold brick because D Corp. is P Corp. When D Corp. goes bankrupt, T gets the brick—and everything else P Corp. owns.

“Piercing the corporate veil” - reaching the assets of P Corp. to satisfy a claim against D Corp. - is widely recognized as one of the least satisfying areas of corporate law.105 Nevertheless, attempts to pierce are frequently litig-
The frequency of litigation and seemingly random success rate testify to the notorious incoherence of veil piercing. Perhaps the only really certain aspect of piercing is that it will not be imposed on minority stockholders of public companies and very rarely when a privately owned corporation is scrupulous in maintaining formalities.

In bankruptcy cases, piercing doctrine is especially chaotic, in part because of imprecision in vocabulary.

A. Spurious Piercing

We define “true” piercing as the legal conclusion that two ostensibly different persons are *one and the same legal person* such that P Corp.’s assets are D Corp.’s assets. If P Corp. is D Corp., P Corp.’s property is part of D Corp.’s bankruptcy estate. This is to distinguish piercing from all other theories as to why nonbankrupt persons should be liable to a bankrupt’s claimants such as agency, actual fraud, fraudulent transfer, breach of fiduciary duty, etc. Although courts often use the language of piercing in such cases, in our view they are examples of spurious piercing because they expressly or implicitly accept the concept that the D Corp. and P are distinct and separate persons.

Consequently, in this article we rehabilitate the oft-derided notion of the “alter ego.” Critics deride the phrase because courts often claim to use it as an analytical term when, in fact, like the term “generalized claim,” it is metaphorical with no analytical bite. Nevertheless, we use the term “alter ego” as a vivid short-hand term for a court’s conclusion that it is engaging in true
to judge’s characterizations of what they are doing. As Steven Bainbridge and M. Todd Henderson suggest, the “true motivation in piercing remains elusive.” Bainbridge & Henderson, supra note 22, at 111.

Peter B. Oh, Veil Piercing Unbound, 93 B.U. L. Rev. 81, 90 (2013). Thompson and Oh find a success rate in piercing actions of over 40% and almost 50%, respectively (Thompson, Piercing, supra note 106, at 1047-48, and Oh, Piercing, supra note 106, at 107-10), although this varies by jurisdiction and cause of action.

Peter Oh calls it “a scourge on corporate law.” Oh, Piercing, supra note 106 at 81. Bainbridge & Henderson, supra note 22, at 117-18.

Id. at 110.

For example, courts often speak of ordering piercing to prevent fraud or other wrongs, but if a fraud exists, then piercing would not be needed. We agree with Bainbridge that, if all of the elements of fraud or another action are not met, a court should not promiscuously invoke piercing as a way of punishing someone who one finds morally repugnant. Stephen M. Bainbridge, Abolishing Veil Piercing, 26 J. Corp. L. 479, 516-17 (2001)

One of the primary problems, however, is that fraud requires reliance by the victim and, in the typical tort case (other than the tort of fraud) in which a court might wish to order piercing there will almost by definition be no reliance.

See e.g. Oh, Unbound, supra note 22, at 83-84; Bainbridge & Henderson, supra note 22, at 130; Hodge & Sach, supra note 22, at 342; David Millon, The Still Elusive Quest to Make Sense of Veil-Piercing, 89 Tex. L. Rev. 15, 20 (2009).
Courts often speak of piercing as a remedy to prevent fraud or other wrongs - and indeed, courts are not supposed to pierce unless they believe that not doing so would cause an injustice. But if a fraud exists, then piercing is not needed. In fraud cases, a court should not promiscuously invoke piercing as a way of punishing someone who one finds morally repugnant. According to Professor Stephen Bainbridge:

In my view, however, the survival of piercing given the availability of these alternative remedies is better explained by the fact that they, especially fraudulent transfer law, require careful review of specific transactions. "What did the corporation transfer [to the shareholder]? What is the defendant’s justification for the transfer? How does this measure up against the specific tests of fairness or solvency imposed by the relevant statute or judicial doctrine?" In contrast, veil piercing merely requires analysis by epithet.

Courts have confusingly invoked the language of “piercing” when, in fact, the issue concerns a basic suretyship obligation of P Corp. In Board of Trustees v. Foodtown, Inc., the court analyzed the case as one entailing piercing the veil between D Corp. and P Corp. In fact, under pension law, P Corp. is effectively the guarantor of D Corp.’s pension liability to a pension creditor C₁. C₁ can have judgment against P Corp., but no other creditor can.

In Foodtown, C₁ sued P Corp. and other defendants because D Corp. had defaulted on pension obligations owing to C₁. P Corp. responded by claiming that, since D Corp. had filed for bankruptcy, T (not C₁) owned the cause of action. This was actually a disastrous argument. Had it succeeded—if we are really talking true piercing—P Corp. would disappear, to be sucked into

112 Confusingly, some courts use alter ego and piercing analysis interchangeably, but others either that alter ego is one of a number of grounds for piercing or an alternate to piercing. Bainbridge & Henderson, supra note 22, at 93-94. See infra text at notes 183-86.
113 See e.g. text infra note 125.
114 Bainbridge, Abolishing, supra note 22, at 522 (quoting Franklin, A. Gevurtz, Piercing: An Attempt to Lift the Veil of Confusion Surrounding the Doctrine of Piercing the Corporate Veil, 76 OR. L. REV. 835, 878 (1997)).
115 296 F.3d 164 (3rd Cir. 2002).
116 Id. at 171.
117 Lumpkin v. Envirolodyne Indus., Inc., 933 F.2d 449, 460-61 (7th Cir. 1991) (“The congressional intent of ERISA is to hold employers responsible for pension benefits, so that when the corporate form poses a bar to liability, 'concerns for corporate separateness are secondary to what we view as the mandate of ERISA') (citations omitted).
the black hole of D Corp.'s bankruptcy proceeding. Luckily for P Corp., the court disagreed and allowed C's lawsuit to proceed.

In its action against P Corp., C claimed that P Corp. was D Corp.'s alter ego and that the corporate veil between them should be pierced. In ERISA cases, it appears, courts will pierce the veil at the request of a pension claimant like C. Thus, a pension claim is not a true piercing theory. It represents the notion that P Corp., when it exercises sufficient control of D Corp., guarantees the pension claim that C has against D Corp.

The Foodtown court analyzed the issue in terms of whether P Corp.'s liability for pension withdrawal was property of D Corp.'s bankruptcy estate. It was not. P Corp. did not owe D Corp. P Corp. owed C. As the court put it, the piercing claim was a particularized cause of action that belonged to C alone, not by the creditors of D Corp. generally.

In this analysis, the generalized/particularized distinction does no real work. Properly, the issue was: Who could sue P Corp. when D Corp. defaulted on pension obligations? D Corp. could not because, in suretyship, the obligor has no rights against the surety. Only the obligee (C) has a cause of action against P Corp. One sees in Foodtown a sort of equation of "property of the bankruptcy estate" and "general creditor rights." It would be cleaner to ask whether D Corp. had any property in a claim against P Corp. Since the answer is no, there is no cause to stay C's ERISA claim against P Corp.

Equally disastrously, C claimed the right to pierce the veil generally. If taken literally, C should be seen as violating the automatic stay. That is, C could only prevail if true piercing was not appropriate to the facts of the case.

119 In addition, the plaintiff alleged that various other defendants had breached fiduciary duties and aided and abetted this breach. The court never explains exactly what relation these other defendants had to D Corp. For a list of defendants, see Id. at 167 n. 1.

120 In a subsequent unpublished lower court opinion in the same bankruptcy case, we learn that the debtor, Twin County Grocers, Inc., was a wholesale cooperative that purchased, warehoused and distributed inventory to various grocery retailers, primarily D Corp. It was owned principally by the owners of D Corp. Vitale was D Corp.'s CEO and director of D Corp. Allegedly, he had been embezzling funds from D Corp. Bd. of Trs. v. Foodtown, Inc, Civ. Action no. 99-3333, 2005 U.S. Dist. LEXIS 56616 at *4 (D. N.J. 2005).

121 "Here, however, [D Corp.'s] withdrawal liability is not property of [D Corp.'s] estate." Id. at 170.

122 "In order for the claim to be the 'legal or equitable interest of the debtor in property,' the claim must be a 'general one, with no particularized injury arising from it.' On the other hand, if the claim is specific to the creditor, it is a 'personal' one and is a legal or only of the creditor. A claim for an injury is personal to the creditor if other creditors generally have no interest in that claim." Id.

123 "Here, there is no general creditors' interest in the statutorily imposed withdrawal liability owed to [C]." Id.

124 The court called piercing "a remedy that is involved when [a subservient] corporation is acting as
Another spurious piercing case is Steinberg v. Buczynski, where Judge Richard Posner refreshingly noted that the personalized/generalized dichotomy is:

not an illuminating usage. \( T \) has no right to enforce entitlements of a creditor. \( T \) represents the unsecured creditors of the corporation; and in that sense when he is suing on behalf of the corporation he is really suing on behalf of the creditors of the corporation. But there is a difference between a creditor's interest in the claims of the corporation against a third party, which are enforced by the trustee, and the creditor's own direct-not derivative-claim against the third party, which only the creditor himself can enforce.

Unlike some of the other cases we have considered, Steinberg did not involve a conflict between a C and \( T \) as to standing to pierce the corporate veil. Rather, \( T \) attempted to bring an action against the SH, a married couple. Despite the fact that Judge Posner characterized this case as a piercing action, once again, on our analysis, it is not clear that this case involved "true" piercing at all. \( T \) was not seeking to attach the assets of SH, or hold them liable for D Corp.'s debts. Rather, \( T \) wished to hold the SH personally liable for one (and only one) of D Corp.'s debts - a judgment for treble damages and attorney's fees for failure to make contributions to an ERISA pension plan.

In his analysis, Judge Posner arguably conflated a piercing action with an action for looting. Although looting, along with commingling of funds and disregard of corporate separateness, may be reasons to conclude that \( D \) and \( SH \) are the same legal person, it is a separate theory of liability with different consequences.

We can imagine an argument that their disregard is a species of wrongdoing that entitles \( [D \text{ Corp.}] \) to recapture all of the moneys that the \([SH]\), however, harmlessly, (for they could have had [D Corp.] pay the moneys to them in the

an alter ego of [a dominant corporation]." Id. at 171 (quoting Peter J. Lahny IV, Securitization: A Discussion of Traditional Bankruptcy Attacks and an Analysis of the Next Potential Attack, Substantive Consolidation, 9 AM. BANKR. INST. L. REV. 815, 865 (2001)). New Jersey follows the typical rule that "(1) one corporation is organized and operated as to make it a mere instrumentality of another corporation, and (2) the dominant corporation is using the subservient corporation to perpetrate fraud, to accomplish injustice, or to circumvent the law." Foodtown, 296 F.3d at 171. The court found that the plaintiff did adequately plead both elements. \( D \text{ Corp.} \) was alleged to be the alter ego of \( P \text{ Corp.} \). Moreover, the "fraud" alleged included "diverted funds, fictitious invoices and kickbacks." Id. at 173. All of these alleged facts seemed to have occurred before the bankruptcy. These allegations, if true, support the funding that at least \( P \text{ Corp.} \) should be considered the same person as \( D \text{ Corp.} \) and, therefore, its assets should be part of the estate.
form of salary), diverted to their personal expenses. In that event \([D\ Corp.]\) would have a claim against \([SH]\), and the trustee could enforce it.\(^{127}\)

But if \(D\ Corp.\) had a cause of action against \(SH\) personally for stealing specific sums paid to them, then \(D\ Corp.\) need not invoke the concept of piercing. A true piercing case would not be an action for the looted funds per se. Piercing asserts that all shareholder assets are property of the bankruptcy estate.

Although he focused on standing to pierce, Judge Posner ultimately based his decision on the merits. That is, he just did not think that the defendants did anything wrong. Although, like so many stockholders of wholly owned corporations, the \(SH\) were lax in obeying the formalistic niceties of corporate law, they did not abuse their power to the detriment of the \(C_8\). That is, the monies that the stockholders took out of \(D\ Corp.\) were not greater than what they could have taken as salary, and the \(SH\) properly paid income taxes on the amounts dividdend out of \(D\ Corp.\).\(^{128}\)

**B. "True" Piercing**

We distinguish piercing from all other theories as to why nonbankrupt persons \((X)\) should be liable to \(C_1\)'s claim against \(D\ Corp.\). Such theories concede that \(P\ Corp.\) and \(D\ Corp.\) are distinct and separate persons. Under these spurious piercing theories, Clark Kent and Superman are separate persons—the theory of ever-clueless Jimmy Olsen.\(^{129}\)

If we have before us true piercing, \(T\) is the proper person to raise the issue because piercing establishes that \(P\ Corp.\)'s property is \(D\ Corp.\)'s property. Where \(P\ Corp.\) and \(D\ Corp.\) are the same person, \(P\ Corp.\)'s gold brick comes into \(D\ Corp.\)'s bankruptcy estate via the familiar portal of Bankruptcy Code § 541(a). But not just the brick! All of \(P\ Corp.\)'s assets come into the bankruptcy estate.

A fundamental conceptual error about true piercing is the notion that piercing is itself a cause of action.\(^{130}\) This category mistake leads to the otiose jurisprudence of generalized creditor rights vs. particularized creditor rights. Tort is a cause of action. Breach of contract is a cause of action. Violation of a

\(^{127}\)Id. at 892.

\(^{128}\)Id. at 891-92.

\(^{129}\)In the classic silver age DC Comics universe, the more savvy Lois Lane suspects that Clark is Superman's alter ego, but is perpetually defeated in her attempts to prove it. See Swift & Co. Packers v. Compania Colombia Del Caribe, S.A., 339 U.S. 684, 689 n. 4 (1950) (the existence of a fraudulent transfer presupposes separate persons, making veil piercing irrelevant).

\(^{130}\)Peacock v. Thomas, 516 U.S. 349, 354 (1996) ("Piercing the corporate veil is not itself an independent ERISA cause of action, but rather is a means of imposing liability on an underlying cause of action") (citation omitted).
statutory obligation is a cause of action. Piercing is not. The true issue is whether \( P \text{ Corp.}'s \) gold brick is property of the \( D \text{ Corp.}'s \) bankruptcy estate. "Causes of action" have nothing to do with that issue. The particularized/generalized dichotomy that we criticize is therefore analytically useless.\(^{131}\)

Presuming (incorrectly) that piercing the corporate veil is a "cause of action," bankruptcy courts often ask whether, outside bankruptcy, \( D \text{ Corp.} \) could pierce its own veil. If so, piercing is like theft claims. They are causes of action that belong to \( D \text{ Corp.} \). Looking to nonbankruptcy state law cases for guidance, however, will rarely be helpful because outside of bankruptcy the issue of so-called "self-piercing" almost never arises. Indeed, to a transactional corporate lawyer, self-piercing outside of bankruptcy seems to be an oxymoron if for no other reason than that is almost always unnecessary.\(^{132}\) Outside of bankruptcy, \( D \text{ Corp.} \) and \( P \text{ Corp.} \) are simpatico.

Indeed, one of the most commonly cited substantive elements in piercing case is that the entity to be pierced (\( D \text{ Corp.} \)) is so dominated by the other entity (\( SH \)) that the pierced entity has no separate will.\(^{133}\) How then, could \( D \text{ Corp.} \) ever have the will to seek to reach the assets of \( SH \) over \( SH \)'s objections?

If closely owned \( D \text{ Corp.} \) wants \( SH \) to pay its debts, it does not need to go to court to get order to do so because \( D \text{ Corp.}'s \) will is determined by its directors elected by \( SH \). Indeed, in the case of closely owned corporations, the same \( SH \) are likely to be the officers and directors. Accordingly, \( SH \) will just pay \( D \text{ Corp.}'s \) debts directly or contribute capital or lend money to \( D \text{ Corp.} \), if she has a mind to do so.

Significantly, the stockholders of a corporation always have the power to destroy corporate form whenever they want in the sense that they can vote to dissolve the corporation entirely. Indeed, \( P \text{ Corp.} \) has the power to destroy corporate form whenever it wants to in the sense that it can vote to dissolve \( D \text{ Corp.} \) entirely.

Self-piercing cases outside of bankruptcy – in which a corporation tries to deny its own separate existence – are rare and rarely successful. Outside of

\(^{131}\) Professor Ralph Brubaker sees piercing as a claim—or more precisely, a creditor power. Therefore, he moves the justification of \( T \)'s standing from § 544(a)(1) to § 544(a), under which \( T \) has the "rights and powers of a creditor who has extended credit and who has obtained a lien. The syllogism is that creditors generally have the power to pierce. Therefore, \( T \) has power to pierce. Brubaker, Piercing, supra note 84. The theory rests entirely on the generalized-particularized distinction that we criticize. But how to explain why the automatic stay restrains \( C \), from suing \( P \text{ Corp.} \) in competition with \( T \)? Under our theory, the automatic stay clearly applies, \( D \text{ Corp.} \) and \( P \text{ Corp.} \) are the same person, and pursuing \( P \text{ Corp.} \) assets is to pursue \( D \text{ Corp.} \) assets.

\(^{132}\) Baillie Lumber Co. v. Thomson, 612 S.E.2d 296, 300 (Ga. 2005) ("[I]t is extremely unlikely that a corporation, outside of the bankruptcy context, would conclude that it is necessary to institute an alter ego action.").

\(^{133}\) Bainbridge & Henderson, supra note 22, at 87.
insolvency, self-piercing almost always involve “inside-out” cases where doing away with separate corporate personhood would insulate an entity from, rather than impose liability on, it. For example, in Boggs v. Blue Diamond,[134] C1, was limited in recovery from its employer D Corp. by worker’s compensation law. C1 therefore sued P Corp., the employer’s corporate parent because P Corp. was independently negligent and at fault for C1’s injury. P Corp. tried to pierce its subsidiary’s veil in order to argue that D Corp.’s worker’s compensation liability limitation applied to P Corp. P Corp. decided to incorporate D Corp. separately in order to enjoy the benefits of limited liability, so P Corp. was estopped from denying its suddenly inconvenient separate personhood.[136] Not surprisingly, the court took the position that P Corp. had made its bed and so must lie in it.

Consequently, although one occasionally finds courts denying self-piercing or reverse self-piercing in bankruptcy on the grounds that it is not permitted under state law, these concerns are surely misplaced. First, the fact that one cannot find a precedent for self-piercing does not mean it is forbidden, only that it has not been raised for the empirical reasons just discussed. To use a familiar cliché about empirical research, lack of evidence is not evidence of lack.

Moreover, as we have just suggested, one should not confuse a state law precedent disallowing self-piercing to avoid a liability with its use to assert D Corp.’s ownership of P Corp.’s gold brick. As the metaphorical language implies, piercing is a sword to impose liability, not a shield to avoid it.

The classic statement of the alter ego theory of piercing is that two entities will be treated as one person not only “when there is such an identity or unity between a corporation and an individual or another entity such that all separateness between the parties has ceased and a failure to disregard the corporate form would be unfair or unjust.”[137] In the typical nonbankruptcy self-piercing case such as Boggs, self-piercing was denied because it would constitute a furtherance of injustice.[138] This tells us nothing about its permissibility of self-piercing when the tables are turned.

Finally, following from this, one must consider the differing nature of fiduciary duties in and outside of bankruptcy. When D Corp. is solvent, its duties (indirectly) to its equity owners. Consequently, the “you made

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[134] 590 F. 2d. 655 (6th Cir. 1979).
[135] Actually, the C1 were the widows of the employees who were killed in the industrial accident, whose rights were derivative of their late spouses.
[136] See also Lumpkin v. Environdyne Indus., 933 F.2d 449, 456 (7th Cir. 1991) (P Corp. wished to pierce its own well because D Corp. had entered into a favorable settlement).
[138] Boggs, 590 F.2d at 663.
your bed" argument with respect to self-piercing by the stockholders of $D\text{ Corp.}$ has some bite when $D\text{ Corp.}$ is solvent. In contrast, when $D\text{ Corp.}$ becomes insolvent, the persons who can bring a derivative action for fiduciary lapses by its officers and directors shift from $P\text{ Corp.}$'s stockholders to the creditors $C_g$ of $D\text{ Corp.}$—the new residual claimants. At state law, the $C_g$ have standing to bring derivative actions on behalf of $D\text{ Corp.}$.\textsuperscript{39} The $C_g$ could, on behalf of $D\text{ Corp.}$, assert that $P\text{ Corp.}$'s brick is $D\text{ Corp.}$'s brick. That would be an in rem claim to the brick itself. Or, alternatively, an individual $C_1$ or $C_2$ could try to impose an in personam liability on $P\text{ Corp.}$ because $P\text{ Corp.}$ is the same person as $D\text{ Corp.}$ This is no claim to the brick at all. It is a claim that $P\text{ Corp.}$ and $D\text{ Corp.}$ are the same person, and that $P\text{ Corp.}$ should suffer an in personam money judgment against it. Consequently, a bankruptcy rule based on self-piercing outside of bankruptcy seems inept when $D\text{ Corp.}$ in bankruptcy wishes to reach the assets of $P\text{ Corp.}$ in order to compensate the $C_g$.

We do not present a study of the literally thousands of piercing cases in and outside of bankruptcy. Moreover, we only reference the substantive grounds for finding that two entities are alter egos insofar as necessary to understand the cases we discuss. This is a matter of state law which is not our primary concern.

A review of the principal appellate cases concerning piercing in bankruptcy reveal incoherent and ad hoc reasoning even if they often reach a correct result (based on our account of true piercing). Some of these cases reveal a shaky grasp of state law. Not only do they often mis-characterize the piercing precedents on which they claim to rely, they sometimes try to apply non-piercing law to piercing.

These decisions often display a basic conceptual confusion about the project at hand. They confuse the two distinct and alternate theories of piercing. The first asks whether a cause of action belongs to a creditor individually, or whether it is property of the bankruptcy estate. In our analysis, a true piercing is not a cause of action at all but an adjudication that two ostensibly separate legal persons—$D\text{ Corp.}$ and $P\text{ Corp.}$—are really one and the same entity such that the assets of $P\text{ Corp.}$ are assets of $D\text{ Corp.}$'s bankruptcy estate. Most vexingly, many courts seesaw between the two theories without recognizing that the theories are mutually exclusive.

Finally, once courts have mischaracterized the issue in terms of the ownership of a cause of action, they often purport to allocate its ownership based on the generalized/personalized dichotomy we criticize. In fact, such a dichotomy does no analytical work.

1. Eighth Circuit

In In re Ozark Restaurant Equipment Co., Inc., an Eighth Circuit panel found that $T$ could not assert an alter ego claim against two 50 percent shareholders. This case is procedurally different from many that we discuss because the issue was not a challenge by $T$ to the standing of $C_1$ to raise piercing against shareholders outside bankruptcy, but a defense raised by the $SH$ in bankruptcy against $T$'s attempt to pierce.

Ozark has three parts, each of which is misguided. The first part might be best analyzed not as a proposition about piercing at all, but as a misinterpretation of Arkansas corporate law. As this is an issue of state, not federal law, it is at best a poor Erie guess that should have little precedential value, especially outside Arkansas.

The Ozark court opined that, under Arkansas law, $D\text{ Corp.}$--and therefore $T$--may not seek to self-pierce its own corporate veil. Consequently, by negative pregnant, a piercing claim belongs solely to the $C_g$. In fact, the primary Arkansas case on which Ozark relies, Thomas v. Southside Contractors, Inc., stands for nothing of the sort. It does not involve piercing or reverse piercing at all. $D\text{ Corp.}$ did not try to self-pierce and no $C_1$ of $D\text{ Corp.}$ tried to attach the assets of $P\text{ Corp.}$ to satisfy $C_1$'s claim against $D\text{ Corp.}$ No party argued that $D\text{ Corp.}$ and $P\text{ Corp.}$ were alter egos of each other. Rather, the case involved the interpretation of a local insurance statute. To pile a Pelion of irrelevancy upon an Ossa of error, the issue of standing to bring a case was never raised.

According to the Ozark court:

[In Arkansas, . . . the courts have held that “[a] corporate entity is to be disregarded only if the corporate structure is illegally or fraudulently abused to the detriment of a third person.” Thomas v. Southside Contractors, Inc., 260 Ark. 694, 543 S.W.2d 917, 919 (1976) (citing Rounds Porter Lumber Co. v. Burns, 216 Ark. 288, 225 S.W.2d 1 (1949)). Thus, the obligations and liabilities of an action to pierce the

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140816 F.2d 1222 (8th Cir. 1987).
141[I]n hazarding an Erie guess, "[o]ur task is to 'attempt to predict state law, not to create or modify it.'" Memorial Hermann Healthcare Sys. v. Eurocopter Deutschland, 524 F.3d 676 (5th Cir. 2008) (citation omitted).
142Id. at 1225 ("Because the corporate entity will be disregarded under Arkansas law only if it has been abused to the detriment of a third person, and because the nature of the alter ego theory of piercing the corporate veil makes it one personal to the corporate creditors rather than the corporation itself, it is axiomatic that the claim does not become property of the estate under Section 541(a)(1), nor is it enforceable by the trustee under Section 704(1).")
143543 S.W.2d 917 (Ark. 1976).
corporate veil in Arkansas do not run to the corporation, but
to third parties, e.g., creditors of the corporation.\textsuperscript{144}

The cited Thomas case was what we call a spurious piercing case. Thomas was an appeal from the Arkansas Employer’s Compensation Commission’s denial of insurance coverage. C, was an employee of a small, closely held corporation that was a subcontractor on an excavation project. When C, was injured on a job, he could not recover from his employer’s workers’ compensation insurance policy because the insurance had been canceled. Consequently, C, sued the primary contractor and its insurer under an Arkansas statute that made a primary contractor and its insurer liable if a subcontractor had inadequate insurance.\textsuperscript{145}

By taking the casual statement in Thomas that corporate form will be respected absent fraud or illegality out of context, the Eighth Circuit concluded that the case stood for the proposition that only a defrauded C, can bring a piercing claim. This is a non sequitur. The statement does not address the standing issue at all.

The second part of Ozark is equally wrongheaded. Here, the Eighth Circuit adopts the conceptual confusion that we have been criticizing: the court assumes that piercing is itself a cause of action, and then frames the question in terms of ownership of that cause of action.

Where, however, the applicable state law makes such obligations or liabilities run to the corporate creditors personally, rather than to the corporation, such rights of action are not assets of the estate under Section 541(a) that are enforceable by the trustee [under Section 704(1)].\textsuperscript{146}

In so opining, the Ozark court claimed support from Caplin, which we

\textsuperscript{144}Ozark, 816 F.2d at 1225.

\textsuperscript{145}The second case which the Eighth Circuit indirectly cited, Rounds & Porter, was indeed a standard piercing case where the issue was whether P Corp. could be held liable for the contractual debt of D Corp. It did not involve issues of self-piercing or standing, however. See id., citing Henderson v. Rounds & Porter Lumber Co., 99 F. Supp. 376, 380 (W.D. Ark. 1951).

The court also invoked American Jurisprudence 2d and Fletcher Cyclopedia to assert its statement that self-piercing is not permitted. Id. The former passage merely reiterates the basic rule of separate corporate personhood, without discussing piercing or any other exceptions. 18 AM. JUR. 2ND CORPORATIONS § 46. The Cyclopedia entry is, at least, entitled the Alter Ego or Mere Instrumentality Doctrine. However, it does not raise the issues of self-piercing or standing. It does assert: Officers and directors of a corporation who avail themselves of the benefits of incorporation cannot pierce the corporate veil and deny existence of the corporation in an effort to avoid liability for breach of their fiduciary duties.

\textsuperscript{146}Ozark, 816 F.2d at 1225 (citation omitted).
Caplin involved the trustee’s lack of standing to bring actions on behalf of a subset of the Cg against an indenture trustee. If, however, one adopts our theory of alter ego in bankruptcy, then Caplin and its progeny are inapplicable. Caplin is simply not a piercing case. Finally, the Eighth Circuit incorrectly concluded that T cannot pierce under his strong-arm power, by which T has the rights of a hypothetical lien creditor of D Corp. This is because, once again, the court misinterprets piercing as a cause of action against a third party.

If, however, alter ego piercing is the recognition that P Corp. is not a separate legal person from D Corp., then the strong-arm power is directly relevant. That is, to speculate hypothetically per Bankruptcy Code § 544, imagine that the trustee has a judgment against D Corp. and obtains a lien on D Corp. assets to secure that judgment. That hypothetical judgment lien would attach to all assets owned by P Corp., which, if the court adopts the alter ego theory, is the same legal person as D Corp. The attachment of this lien is not an attempt to bring a cause of action, but the enforcement of a judgment deemed obtained by T against D Corp. To return to our example, if one obtains a judgment against Clark Kent, then one can enforce that judgment by attacking Superman’s property in the Fortress of Solitude because Superman is Clark Kent and already subject to that judgment.

2. Ninth Circuit

In Ahcom, Ltd. v. Smeding, a Ninth Circuit panel ruled that, even though D Corp. was bankrupt, C1 could sue SH because, in general, T could not. As in Ozark, piercing was seen as a particularized creditor right. Also as in Ozark, this holding was an Erie guess—probably a poor one based on a misreading of California case law—though Ahcom has one lower appellate opinion in support of its holding.

In Ahcom, C1 entered into a contract with D Corp. When D Corp. breached, C1 prevailed in arbitration. D Corp. then filed for bankruptcy. C1 brought an action against SH to enforce the arbitration award, alleging that SH was D Corp.’s alter ego. SH defended on the grounds that only T could make such a claim. The district court agreed; C1 was illegitimately “asserting a claim that harms... all creditors and thus this [i.e., the alter ego] claim is exclusively the property of [T].” Accordingly, the district court dismissed
the case.

The Ninth Circuit reversed and held that C₁ could proceed. T, the court found, could not have proceeded because California law does not recognize a generalized alter ego cause of action: "In fact, there is no such thing as a substantive alter ego claim at all: 'A claim against a defendant based on the alter ego theory, is not a claim for substantive breach of contract or to set aside a fraudulent conveyance, but rather, procedural . . ." ¹⁵⁴

Seemingly, the statement that alter ego is not a cause of action is on the money. As authority for this proposition, the Ahcom court cites Hennessey's Tavern, Inc. v. American Air Filter Co.,¹⁵⁵ where C₁ sued D Corp. on June 6, 1980. California law required a "new" party to be served with the original complaint by June 6, 1983. C₁ served an amended complaint naming SH for the first time on July 16, 1985. The court held that the statute did not apply to SH because SH was not a "new" party. SH was the nom de guerre of D Corp., named in the original complaint. D Corp. was Clark Kent and SH was Superman.

Hennessey's accords with our notion of true piercing. C₁ had sued Clark Kent and added Superman's name over three years later. Superman was not a "new" party. But the Ahcom court seems to have misunderstood Hennessey's. It took Hennessey's to mean that piercing is not a cause of action that belongs to T. It is, however, a cause of action—one that belongs only to the C₁. Thus, it was a generalized creditor right that was nevertheless treated as a particularized creditor right. As the Ninth Circuit summarized the matter:

Thus, we conclude that California law does not recognize an alter ego claim or cause of action that will allow a corporation and its shareholders to be treated as alter egos for purposes of all the corporation's debts. Just because [T] could not bring such a claim against [SH] under California law, there is no reason why [C₁'s] claims against [SH] cannot proceed.¹⁵⁶

Confusing matters, however, is Stodd v. Goldberger,¹⁵⁷ which was heavily relied upon in Ahcom. In Stodd, T (in the days of restricted bankruptcy court jurisdiction prior to the Bankruptcy Code) sued P Corp. in state court on an alter ego theory, apparently seeking a money judgment for "all of [D Corp.'s] debts."¹⁵⁸ The claim was odd because T should have sought a turnover order

¹⁵⁴Id. at 1251.
¹⁵⁶Ahcom, 623 F.3d at 1252.
¹⁵⁸Id. at 70.
of property on the theory that $P$ Corp.'s property was $D$ Corp.'s property. A money judgment against $P$ Corp. is a contradiction. How can Clark Kent sue Superman personally?

In Stodd, the trial court threw $T$ out of court and $T$ unsuccessfully appealed. The court of appeal affirmed:

But $[T]$ misreads the message of the trial court. Its ruling was not that allegation of conversion or misappropriation of corporate property is generally a prerequisite to the application of the doctrine of alter ego, but that $[T]$ cannot maintain an action against $[P$ Corp.] on an alter ego theory absent some allegation of injury to $[D$ Corp.] giving rise to a right of action in it against $[P$ Corp.].

What Stodd seemed to be saying was that $T$ could bring actions that $D$ Corp. owned, such as conversion of assets. But $T$ could not bring an action for a money judgment against $P$ Corp. just because $D$ Corp. was $P$ Corp. Unfortunately, this got misread by some federal courts: the proposition gleaned was that $T$ could sue to pierce the veil if $T$ threw in some allegations that $P$ Corp.'s actions harmed $D$ Corp. The Ahcom court corrected the record. Stodd was actually saying that if $T$ wanted to sue $P$ Corp., then $T$ would have to discover some tort theory that $D$ Corp. could have brought against $P$ Corp. Per Stodd, $T$ could have no money judgment against $P$ Corp. But, it seems to us, $T$ could seek turnover orders requiring those in possession of $P$ Corp. assets to hand them over to $T$ (because they are really assets of the bankruptcy estate).

In In re Davey Roofing, Inc., $C_1$ had a claim against $D$ Corp. and sued $SH$ on a piercing theory. $D$ Corp. filed for chapter 11 bankruptcy, where $D$ Corp. was debtor-in-possession (DIP). The DIP put together a plan under which $SH$ would contribute his (substantial) assets to the DIP estate in exchange for a release from creditors such as $C_1$. The DIP then sought a

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159 In re Kaiser, 791 F.2d 73 (7th Cir. 1986). The Kaiser case is a peculiar one. It starts off being a piercing claim by $T$ against $SH$, but then the court denies that $D$ Corp. owns all of SH's property. $D$ Corp. owned only so much of it as $D$ Corp. actually possessed. Thus, artwork on the walls belonged to $SH$ not $D$ Corp., because shareholders often hang artworks in corporate headquarters. Under a proper piercing theory, $SH$ and $D$ Corp. are the same person. All of SH's property is $D$ Corp.'s property, including SH's home and the artwork, whether at the home or the office.

160 Stodd, 141 Cal. Rptr. at 71.

161 See e.g., Koch Refining v. Farmers Union Central Exchange, Inc., 831 F.2d 1339, 1347 (7th Cir. 1987) ("A fair rephrasing of the Stodd ruling is that, if a trustee of a bankrupt corporation has an interest in recovering from nondebtor fiduciaries on an alter ego theory, he must allege injury to the corporation giving rise to a right of action in alter ego against the fiduciaries.").


163 Id. at 606 ("Davey has also provided financial statements, on a confidential basis, which assert that the capital contribution and residence constitute Davey's only substantial assets. In return for encumber-
declaration that this was kosher. The court found it was. Citing Stodd, the court announced, "Under California law . . . a corporation may pierce its own corporate veil if equity demands." It took Stodd to be saying that T could pierce if T could prove harm to D Corp. But in the end, Davy looks like a case where SH looted D Corp. and thereafter settled the looting claim. If so, Davy was a spurious piercing case.

Ahcom also criticized the Stodd reading that appears in CBS, Inc. v. Folks (In re Folks). In Folks, C1 had a claim against D Corp. D Corp. was bankrupt. SH soon followed with a voluntary bankruptcy petition. C1 sought to file a claim in SH's bankruptcy and sought to bar a discharge from this claim. SH objected that C1 had no claim in the SH bankruptcy because piercing theories belonged to T. The court, citing Stodd, agreed, but because D Corp.'s bankruptcy trustee had abandoned any piercing theory, C1 could proceed. The Folks court used the full-dress generalized/particularized distinction to conclude that piercing was a generalized creditor right belonging to T alone.

The Ahcom reading of Stott seems correct. But its use of Mesler v. Bragg Management Co. is not. Citing Mesler, Ahcom proclaimed its reading of Stodd is "unavoidable when we consider that no California court has recognized a freestanding general alter ego claim that would require a shareholder to be liable for all of a company's debts and in fact the California Supreme Court state that such a cause of action does not exist." In fact, Mesler does not stand for any such proposition. Insofar as that case dealt with the concept of creditor generality, it was with respect to a completely different definition of the word "general." Mesler had absolutely nothing to do with the procedural issue of whether D Corp. (or T) can bring a self-piercing claim. Indeed, in context we believe Mesler should be read narrowly as a contract interpretation case in which the court unfortunately used overly broad and irrelevant language.

In Mesler, C1 was injured in an industrial accident and sued his employer,
D Corp. He included as defendants a number of other parties, including the prior owner of the equipment involved in the accident, on agency and alter ego theories. At some point C, settled with the former equipment owner. However, after two years of litigation against D Corp., C, learned that D Corp. and the former equipment owner (i.e., the party released in the settlement) were wholly owned subsidiaries of the same P Corp. That is, it turned out that D Corp. and the equipment owner were corporate siblings. C, then moved to include P Corp. in its suit on an alter ego theory.171

On appeal, P Corp. argued that it could not be sued because the contractual release of the sibling was release of the parent. The California Supreme Court rejected this argument, noting that although piercing must be decided on a case by case basis, the two elements of piercing under California law were “(1) that there be such unity of interest and ownership that the separate personalities of the corporation and the individual no longer exist and (2) that, if the acts are treated as those of the corporation alone, an inequitable result will follow.”172 Based largely on California’s common and statutory law of release of joint and several tortfeasors, the Supreme Court found that the release of one subsidiary was not a release of P Corp.173

Presumably, the Mesler court was concerned that, if veil piercing is supposed to prevent injustice by imposing liability on an affiliate, it would be unjust to find that the release protected P Corp. from liability in this case where C, did not even know P Corp. existed when it granted the release. In short, Mesler is an “inside-out”174 case where piercing would insulate P Corp. from liability, rather than imposing it. do. Piercing is a sword for C, (and in bankruptcy for T), not a shield for P Corp.

As such, we think that Mesler should be limited to its facts—that is, an interpretation of a particular settlement agreement. The question was: whom did C, intend to release? Since, at the time the release was entered into, C, did not know that P Corp. existed, it almost certainly did not intend to release P Corp.175

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171The lower court would eventually hold that C, could not amend its complaint to include P Corp. on timing grounds. Mesler v. Bragg Management Co., 219 Cal. Rptr. 983, 993 (Cal. App. 1990). So all of this was empirically irrelevant to the parties (but not to their lawyers, who dreamt straight on fees).

172Mesler, 702 P.2d at 606-07 (quoting Automotriz etc. de California v. Resnick, 306 P.2d 1, 3 (1957)).

173Mesler, 702 P. 2d at 610. For a very similar holding, see Lumpkin v. Envirotyme Indus., 933 F.2d 449, 459 (7th Cir. 1991) (P Corp. wished to pierce its own veil because D Corp. had entered into a favorable settlement).

174See supra text accompanying notes 127-28.

175To test this, let us take P Corp.’s argument to its logical extreme. C, was arguing not merely that the parent was the sibling’s alter ego, but that the sibling and P Corp. were D Corp.’s alter egos as well. Following P Corp.’s logic, since all three companies were alter egos, the release of the sibling would have also released D Corp. P Corp.’s lawyer did not dare make this argument since it was pretty clear that this was not the parties’ intent. The intent was that the litigation continue against the employer, just not against the sibling.
Presumably, the language in Mesler on which the Ahcom court relied was the following:

It is not that a corporation will be held liable for the acts of another corporation because there is really only one corporation. Rather, it is that under certain circumstances a hole will be drilled in the wall of limited liability erected by the corporate form; for all purposes other than that for which the hole was drilled, the wall still stands. When it is claimed that a parent corporation should be liable because it is the alter ego of its subsidiary, equity commands that the corporate wall be breached. Yet the wall remains: the parent is liable through the acts of the subsidiary, but as a separate entity. A judgment obtained against a corporation and its alter ego is enforceable against both separately. Thus, when the plaintiff settles with only the subsidiary, the parent's liability continues. To hold otherwise would be to defeat the policy of promoting justice that lies behind the alter ego doctrine.176

This statement that a piercing in one circumstance does not mean that the corporate veil is pierced for all circumstances must be read in the context of the language we have italicized. Nevertheless, the California court's broad language can indeed be read as saying that California does not recognize our understanding of "true" alter ego status—that courts should find that D Corp. is P Corp. all purposes. In this sense, piercing is not generalized, but fact-specific. However, this is a question as to California's substantive law of piercing and does not address the procedural issue faced by the Ninth Circuit as to who has standing to raise piercing.

In the end, Mesler may or may not stand for the proposition that the veil will be pierced for some but not for all purposes. This has absolutely nothing to do with the dubious generalized/particularized dichotomy that we have criticized in the procedural context of who has standing to raise piercing claims.

Despite its reliance on the meretricious generalized/particularized distinction, the Ninth Circuit makes one statement with which we agree: There is no such thing as a cause of action for piercing the veil. Unfortunately, the Ninth Circuit's (correct) statement that alter ego is not itself a cause of action contradicts its holding that the action can go forward in state court because it belongs to C, not to T.

3. Fifth Circuit

So far we have seen that the Eighth and Ninth Circuits think piercing is a

176Mesler, 702 P.2d at 607 (emphasis added).
cause of action that belongs to $C_1$, not to $T$. An early, oft-cited Fifth Circuit opinion considered the issue of standing in *In re S.I. Acquisition, Inc.* In contrast to the Eighth and Ninth Circuits, the Fifth Circuit Court of Appeals found for $T$. We agree with the result, but not the reasoning of the case.

Specifically, *S.I.* held that the automatic stay did apply to $C_1$'s attempt to sue *P Corp.* on an alter ego theory. Unfortunately, in doing so, the court was unable to decide what its theory of the case was. Indeed, it did not recognize that it had two different theories, between which it unconsciously oscillated. Sometimes, the issue was (appropriately) whether the assets of *P Corp.* were property of *D Corp.*'s bankruptcy estate. At other times the court assumed that piercing was a cause of action; it was a piece of property, and the issue was whether it was property of *D Corp.* or property of $C_1$. These two positions are mutually inconsistent because the former considers *D Corp.* and *P Corp.* to be a single legal person, whereas the latter considers *D Corp.* and *P Corp.* to be separate persons.

The bankruptcy court had assumed that the issue was the ownership of the cause of action and that it belonged to $C_1$, not the estate. Consequently, the automatic stay did not apply to constrain $C_1$. Although this is incorrect, it is at least internally consistent.

In reversing, the Fifth Circuit noted that, although the stay cannot be used to protect a nonbankrupt party, there is precedent in other circuits that “in circumstances where the debtor and the nonbankrupt party can be considered one entity or as having a unitary interest, a section 362(a)(1) stay may suspend an action against a nonbankrupt codefendant.” That is, piercing denies the separate personhood of *D Corp.* and *P Corp.*

On the other hand, Fifth Circuit purported to rely on an earlier precedent, the notorious *In re MortgageAmerica Corp.*, as establishing three guiding principles for application of the automatic stay. Tellingly, *MortgageAmerica* did not involve piercing. Rather, it was a fraudulent transfer and a “trust fund” case. The three principles induced by the *S.I.* court from *MortgageAmerica* are:

(1) a section 362(a)(3) stay applies to a cause of action that under state (or federal) law belongs to the debtor only;

(2) a section 362(a)(3) stay applies to a cause of action that seeks to recover property of the estate where the property is

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177 817 F.2d 1142 (5th Cir. 1987).
178 Id. at 1145.
179 Id. at 1148 (emphasis added).
180 714 F.2d 1266 (5th Cir. 1983). The case presumes that *D Corp.* can avoid the fraudulent transfers it has made, and *T* inherits this power from *D Corp.* See Carlson, *Logical Structure*, supra note 15, at 179-82; Carlson, *Organizing Principle*, supra note 51, at 577-78.
held or controlled by a person or entity other than the debtor; and
(3) in applying the above rules we do so by keeping in mind the Bankruptcy Code's general policies of securing and preserving the debtor's property and of ensuring equal distribution of the debtor's assets to similarly-situated creditors.181

MortgageAmerica involved three causes of action against \( D \) Corp.'s controlling stockholder namely, corporate trust fund, fraudulent transfer and denuding of a trust fund. Violation of a trust fund, fraudulent transfer and denuding are all direct causes of action against \( P \) Corp. But, if such a direct cause of action exists, there is no reason to pierce \( D \) Corp.'s corporate veil to reach them.

Nevertheless, in applying MortgageAmerica (not a piercing case) to the question of piercing, the Fifth Circuit asked two important questions:

(1) does \([T's]\) cause of action based on alter ego under Texas law belong to the corporate debtor . . . ; or
(2) does \([C_1's]\) cause of action based on alter ego seek to recover or control property of the debtor . . . ?182

The S.I. court found that because MortgageAmerica answered yes to the first question – finding that the three (non-piercing) causes of action belonged to the estate – it did not have to consider the second question. This is correct, but it is because MortgageAmerica was not a piercing case at all. As such, MortgageAmerica is irrelevant to an actual piercing case.

Nevertheless, looking to Texas law for guidance as to what Nevada law might be, the S.I. Acquisitions case applied MortgageAmerica as though it were a piercing case. It stated that "Texas' alter ego law . . . rests upon an identity theory — the corporation and the control person or entity are considered to be a single entity."183 This statement would seem to indicate that the court was adopting our analysis of piercing that goes not to the ownership of the cause of action (because there is no separate cause of action), but to the assets that would satisfy some other cause of action.

Unlike some other states that consider alter ego and piercing to be the same, Texas (and by extension Nevada) considers alter ego as only one of a number of alternate types of "piercing," or so concluded the Fifth Circuit.184 Apparently, unlike alter ego, which is a means of enforcing a cause of action, other theories of piercing might themselves be separate causes of action im-

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181S.I. Acquisition, 817 F.2d at 1150 (emphasis added).
182Id. at 1151 (emphasis added).
183Id. at 1152.
184Id.
posing liability. The Fifth Circuit then asked whether under Texas (and by extension, Nevada) law, a corporation can bring an action to pierce its own veil.

The Fifth Circuit correctly noted that the fact that there are no self-piercing cases in a state's courts does not in and of itself suggest they are not permitted by the law of that state. As we have noted, outside of bankruptcy it is hard to see how such a case would come up as an empirical matter because "the [corporate parents] who so completely dominate the [its subsidiary] as to constitute its alter ego are not likely to institute an action to determine their own liability for corporate debts." The Fifth Circuit further held that:

The remedy of alter ego under Texas law appears to be available to all creditors of the corporation so long as the requisite melding of the corporation and its control entity are established. The doctrine of alter ego does not rest upon a particular creditor's dealings with or reliance on the control entity, nor does the doctrine require a showing of fraud on a particular creditor. Although confusingly put, this can be read as consistent with our assertion that, under alter ego, D Corp. and SH are the same person. But it is inconsistent with the Fifth Circuit's other claim that alter ego is not the sole theory of piercing under Texas and Nevada law.

After finding (incorrectly) that an alter ego claim is property of the estate, the Fifth Circuit, as a secondary justification for imposing the automatic stay against C, invoked the particularized/generalized dichotomy that we condemn as conclusory. That is, since C,'s claim could be asserted by, and would benefit, all of the creditors, it would violate bankruptcy policy to allow C, to seek the assets of P Corp. on a first-come, first-served basis. Moreover, if the court allowed C, to proceed against the corporate parent, then all the other C,\C, of D Corp. could do so.

The Fifth Circuit returned to the issue of piercing in Schimmelpenninck v. Byrne (In re Schimmelpenninck), in which it, once again, vacillated between the two different approaches to reverse piercing without realizing the internal inconsistency of doing so. In this reverse piercing case, D Corp. was subject to a Dutch insolvency proceeding. P Corp. sued D Corp. in a Texas

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185Id. at 1153.
186Id. (quoting In re Western World Funding, Inc., 52 B.R. 743 (Bankr. D. Nev. 1985)).
187S.I. Acquisition, 817 F.2d at 1152 (emphasis added).
188In set theory notation, "\" means subtraction. Thus, C\C, means the subset of C, who are not C,.
189183 F.3d 347 (5th Cir. 1999).
state court on an alter ego theory. D Corp.'s Dutch curators sought to enjoin P Corp.'s action. The bankruptcy and district courts refused to enjoin on the grounds that Texas law does not recognize reverse piercing, and so the cause of action did not belong to D Corp. The Fifth Circuit reversed on the grounds that the lower courts misapplied the rule of S.I. Acquisitions.

The Schimmelpenninck court noted that the two prongs of S.I. Acquisitions are disjunctive, not conjunctive. This is not only correct but is necessarily the case because, being mutually exclusive, they cannot both be met. It held that, in S.I. Acquisitions, the court did not have to analyze the second prong – whether property of P Corp. is property of D Corp. – because it found that the first prong – that the cause of action belonged to D Corp. under Texas law – had been met. Here, even though D Corp. could not bring the (non-existent) alter ego action under state law, D Corp.'s curators were entitled to the injunction under the second prong that P Corp. was attempting to recover or control of the D Corp.'s property. This ruling is consistent with our analysis. A cause of action under the first prong would not be a true piercing case, but rather a direct cause of action of D Corp. against P Corp. This is completely distinct from the issue of whether D Corp. and P Corp. are one person so that D Corp., and therefore its bankruptcy estate, has an equitable interest in the property of P Corp.

Unfortunately, in so doing, the court once again confusingly and unnecessarily claimed to apply the generalized/personalized dichotomy, which is conclusory if one is deciding who "owns" a cause of action. More importantly it is completely inapt if one is determining whether P Corp.'s assets should be considered assets of D Corp. on either alter ego or single enterprise theory. It merely restates what follows from the conclusion.

We conclude that [P Corp.'s] alter ego and single business enterprise claims against [D Corp.] as asserted in [P Corp.'s] lawsuit, advance a general grievance of all of [D Corp.'s] creditors (not a personal grievance exclusive to [P Corp.]) which must be asserted, if at all, by the Curators for the ultimate benefit of the creditors.

Although this statement is correct, it adds nothing to the analysis that P Corp.'s assets should be considered assets of D Corp. on either alter ego or single enterprise theory. It merely restates what follows from the conclusion.

190The facts of the case are complex. P Corp. had originally owned the company that was sold to D Corp. As a result of the sale, P Corp. became a stockholder of D Corp. and had managed the subsidiary on behalf of D Corp. P Corp. claimed that D Corp. was contractually obligated to redeem its stock. The Texas trial court found that there was no such contract, and from this P Corp. appealed. Id. at 352—53.

191Id. at 358-59.

192Id. at 350.

193Id. at 352.
that they are the same person—namely that the Cc will share those assets pro rata. Indeed, this dichotomy, even if were coherent, could only apply to the first, not the second, prong of MortgageAmerica. It is irrelevant to the second prong on which the court was supposedly relying.

In Southmark Corp. v. Crescent Heights VI, Inc. (In re Southmark Corp.), the court considered T’s ability to pierce a veil between D Corp. and S Corp., its subsidiary. In concluding that T had no such standing, the court implied (appropriately) that ordinary piercing is not a cause of action at all, but reverse piercing (inappropriately) was a cause of action—a particularized creditor right to which T had no access.

In Southmark, S Corp. allegedly made a fraudulent transfer to a third party X. Later, D Corp. and S Corp. merged. The merged entity (D Corp.) soon filed for bankruptcy. T sued X for the value of the fraudulently transferred thing. T’s theory was that D Corp. “exercised full and complete control and dominion” over S Corp., such that D Corp. and S Corp. were the same entity.

Properly, T’s claim was not that S Corp.’s thing was D Corp.’s thing. Rather, T could claim that creditors of S Corp. (Csc.) were creditors of D Corp., and T was subrogated to the fraudulent transfer rights of the Csc. T should have asserted a combined piercing-fraudulent transfer theory.

Suppose the facts did not justify piercing. Without piercing, T had no § 548(a) claim against X. Section 548(a) requires that D Corp. transfer its own property in fraud of its creditors. If S Corp. were a separate person at the time of the fraudulent transfer, S Corp. transferred S Corp.’s property, not D Corp.’s property. Therefore, without piercing, T had no cause of action under § 548(a). On the other hand, the Csc. are also post-merger creditors of D Corp. If T could identify a triggering Csc. in the D Corp. bankruptcy, then T could subrogate to that Csc. and avoid the S Corp.-to-X transfer. But if piercing were appropriate, then T also has a § 548(a) theory because S Corp.’s property was D Corp.’s property at the time S Corp. transferred to X. In that case, T could also use Cdc. (creditor of D Corp.) as the § 544(b)(1)

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195The nature of the thing transferred was rather outre. X had borrowed money ($23.5 million) from S Corp. and issued a promissory note. Later, S Corp. agreed to accept less than the amount of the note ($18.25 million) as payment in full. The fraudulently transferred thing was the value that S Corp. lost ($5.25 million) in the settlement. Stated otherwise, the fraudulent transfer thing was S Corp.’s payment intangible for $5.25 million, which S Corp. transferred back to X, S Corp.’s account debtor. See id. at *3 (“As representative of the bankruptcy estate, Southmark brought the instant adversary proceeding against [X], alleging that [X] received a fraudulent transfer when [X] made the discounted payoff of the notes”).
196Id. at *15.
197T was the debtor-in-possession in a chapter 11 case.
198Id. at *3.
trigger.\textsuperscript{199}

The \textit{Southmark} court made a dizzying collection of wrong turns in its analysis and ultimately reached the wrong destination. First, the court thought that \textit{T} had to show that the fraudulently transferred thing was in fact \textit{D Corp.}'s thing at the time of the fraudulent transfer, which would follow if piercing were appropriate. \textit{S Corp.}'s thing was indeed \textit{D Corp.}'s thing if \textit{S Corp.} had assigned it to \textit{D Corp.} and then, as \textit{D Corp.}'s agent, \textit{S Corp.} had conveyed \textit{D Corp.}'s thing to \textit{X}. The court held there was no evidence that \textit{S Corp.} ever transferred the thing to \textit{D Corp.}. It remained \textit{S Corp.}'s thing at the time \textit{S Corp.} conveyed it to \textit{X}.\textsuperscript{200}

Next, \textit{T} claimed \textit{D Corp.} "controlled" the thing prior to \textit{S Corp.}'s transfer of it and therefore it was \textit{D Corp.}'s thing when \textit{S Corp.}, as agent of \textit{D Corp.}, transferred it to \textit{X}. The court ruled that \textit{D Corp.}'s control of the thing was "not unfettered,"\textsuperscript{201} by which it presumably meant that \textit{D Corp.} and \textit{S Corp.} were separate persons and \textit{D Corp.} did not own the thing.

Finally, \textit{T} claimed \textit{S Corp.} was \textit{D Corp.}'s alter ego.\textsuperscript{202} The court described the consequences of the alter ego theory: "Presumably, this [combined] entity would own both the fraudulent transfer action asserted by [\textit{D Corp.}] as the debtor in this case and [the transferred thing]."\textsuperscript{203} This is wrongheaded. The fraudulent transfer action was owned by the \textit{CSC} of \textit{S Corp.}, not by \textit{S Corp.}\textsuperscript{204} Since \textit{S Corp.} owned no cause of action against \textit{X}, neither did \textit{D Corp.} under a piercing theory.\textsuperscript{205}

The court held that, outside of bankruptcy, \textit{D Corp.} could indeed pierce its own veil. "While [piercings] are usually mounted by creditors of a corporation, we have concluded that Texas law would even permit a corporation seeking 'to meet its corporate obligations' to pierce its own corporate veil 'to hold accountable those who have misused the corporation.'"\textsuperscript{206}

Nevertheless, \textit{T} lost. Outside bankruptcy, \textit{D Corp.} could pierce in an

\begin{footnotesize}
\textsuperscript{199}See 11 U.S.C. § 554(b) (trustee has powers of a creditor holding a judgment lien).

\textsuperscript{200}The court refers to an "equitable" assignment. \textit{Southmark}, 1996 U.S. App. LEXIS 43591 at *10. But the phrase "equitable" could have been dispensed with.

\textsuperscript{201}Id. at *15.

\textsuperscript{202}The court viewed "alter ego" as one of three theories of piercing, id. at *16-*17, when it should have viewed "alter ego" as announcing the result that piercing has been successfully implemented. The other two theories of piercing were "illegal purpose" and "sham to perpetuate a fraud."

\textsuperscript{203}Id. at *16.

\textsuperscript{204}This was the MortgageAmerica error. See \textit{supra} note 181.

\textsuperscript{205}Yet, thanks to the \textit{actual} merger of \textit{D Corp.} and \textit{S Corp.}, the \textit{CSC} were also \textit{CSCD Corp.} The trustee could subrogate to the \textit{CSC} and could avoid \textit{S Corp.}'s fraudulent transfer of the thing. The court did not need the alter ego theory. \textit{T} should have prevailed because of the \textit{actual} merger.

\textsuperscript{206}\textit{Southmark}, 1996 U.S. App. LEXIS 43591 at *17, citing \textit{S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc.} (in re \textit{S.I. Acquisition}), 817 F.2d 1142, 1152 (5th Cir. 1987). In \textit{S.I.}, the \textit{CSC} sued non-bankrupt \textit{S Corp.} as alter ego of bankrupt \textit{D Corp.} The Fifth Circuit held that the \textit{CSC} had violated the automatic stay arising from \textit{D Corp.}'s bankruptcy proceeding.
\end{footnotesize}
upward direction to claim that a shareholder’s property was \( D \text{ Corp.} \)'s property. But \( D \text{ Corp.} \) could not reverse pierce. That is, \( D \text{ Corp.} \) could not claim that \( S \text{ Corp.} \)'s property was \( D \text{ Corp.} \)'s property. The reason was that \( D \text{ Corp.} \) made its own bed and must so lie in it. \( D \text{ Corp.} \) had established \( S \text{ Corp.} \) as a separate entity; now \( D \text{ Corp.} \) was estopped (but as against whom?) from denying \( S \text{ Corp.} \)'s separate existence. Only \( C_{DC} \) could make this claim. In short, the court viewed upward piercing as not a cause of action of the \( C_{DC} \), but downward (or reverse) piercing as a particularized creditor right.

In this case, \([D \text{ Corp.}]\) seeks to use reverse piercing to bring one of \([S \text{ Corp.}]\)'s assets—the note—into its estate so that it may assert a fraudulent transfer action against \([X]\) based on a transaction involving the note. This particular use of reverse piercing, however, is distinguishable in at least one critical respect from the Texas cases that have recognized the reverse piercing remedy. In those cases... it was a third party that sought to employ reverse piercing to avoid the inequity of allowing an adverse party to abuse the corporate form by secreting its assets in a separate entity. In \([T's]\) case, the party seeking to disregard the corporate form is the very entity that abused that form in the first place... What \([T]\) proposes is to allow the party who abused the corporate form to employ the equitable remedy to disregard that form for its own benefit.\(^{207}\)

Since \( T \) did not inherit this \( C_{DC} \) right, \( T \) had no standing to pursue \( X \) for the fraudulent transfer by \( S \text{ Corp.} \).

4. Seventh Circuit

The Seventh Circuit has considered whether piercing belongs to \( T \) or to \( C_1 \) in a handful of cases. In \( Koch \text{ Refining v. Farmers Union Central Exchange, Inc.}^{208} \) the court favored \( T \), upholding the dismissal of an action by \( C_1^{209} \) seeking a declaration that \( D \text{ Corp.} \)'s shareholders (\( SH \)) were the alter egos of \( D \text{ Corp.} \). The \( SH \) moved to dismiss on the theory that the \( C_1 \) had no standing to pierce the veil. \( T \) had already sued the \( SH \) on this score, claiming they “should be liable for all of the debtor's debts as its ‘alter ego’ under a

\(^{207}\)Southmark, 1996 U.S. App. LEXIS 43591 at *18-*19 (emphasis in original). There is much imprecision in this remark. First, the fraudulent transfer thing is forgiveness of the note, not the note as such. Second, the court confuses \( T \) (the debtor-in-possession) with \( D \text{ Corp.} \) (the prepetition entity). \( D \text{ Corp.} \) may have caused \( S \text{ Corp.} \) to be incorporated and is estoppable. But \( T \) (a separate entity) should not be estopped.

\(^{208}\)831 F.2d 1339 (7th Cir. 1987).

\(^{209}\)\(C_1\) was comprised of 11 oil companies that sold oil to \( D \text{ Corp.} \).
‘piercing the corporate veil’ theory.” \(^{210}\) \(T\) was also suing the \(C\) for having received voidable preferences from \(D\) Corp. The \(C\) argued that they were entitled to recover from the \(SH\) all amounts that \(T\) might recover from them as preferences. That is, if the \(C\) had to pay \(T\) for recovered voidable preference, then \(C\) should be reimbursed by the \(SH\). \(^{211}\)

As the Fifth Circuit did in \(S.I.\) Acquisitions, \(^{212}\) the Seventh Circuit vacillated between the two conflicting issues of who owned a piercing cause of action and whether \(SH\) assets were part of the bankruptcy estate. These are mutually exclusive theories as a logical matter. If piercing is a cause of action, then \(D\) Corp. (as plaintiff) is a separate person than the \(SH\) (as defendants).

The district court found that \(C\) lacked standing to bring the cause of action – not making clear what action it was talking about. However, \(C\)’s argument had been negative – not so much affirmatively asserting that \(C\) had standing to bring the action, but denying that \(T\) lacked standing. Presumably, \(C\)’s position was that someone must be able to bring the action so that, if it can’t be the trustee, then it must be \(C\). Consequently, the court concentrated on \(T\)’s rights even though \(T\) was not a party to the case. \(^{213}\)

The court initially began its analysis consistently with our theory of “true” piercing. It referenced \(T\)’s “duty to marshal the debtor’s property for the benefit of the estate, and thus the right to sue parties for recovery of all property available under state law.” \(^{214}\) This assumes that the \(SH\) were the same legal person as \(D\) Corp. According to the Koch court:

> When certain state-governed requirements are met, the alter ego theory allows the legal distinction between a corporation and its shareholders, directors and officers to be disregarded or set aside in order to reach the assets of those individuals “behind the corporation.” \(^{215}\)

Further,

\(^{210}\)Koch Refining, 831 F.2d at 1440.

\(^{211}\)The claim that \(SH\) must reimburse the \(C\) for their preference liability is not one we have encountered elsewhere, but it makes sense. If \(T\) had pierced the \(SH\) veil and rendered the bankruptcy estate solvent, the \(C\) would not be liable for preferences. But the Koch court rightly saw that, if \(T\) took charge of the piercing, the \(C\) would have been paid 100% on the claims against \(D\) Corp. revived as a result of preference avoidance. \(11\) U.S.C. \(\S\) 502(h). This would have reimbursed the \(C\) entirely for the preference disgorgements. The \(C\) tried to cover themselves in a Caplin cloak, claiming that, as preference defendants, the \(C\) were a proper subset of \(D\) Corp.’s creditors. The court rightfully rejected this argument. Koch Refining, 831 F.2d at 1352-53.

\(^{212}\)See supra text at notes 178-87.

\(^{213}\)Koch Refining, 831 F.2d at 1442.

\(^{214}\)Id. at 1343, quoting Sampsell v. Imperial Paper Color Corp., 313 U.S. 215, 219 (1941).

\(^{215}\)Koch Refining, 831 F.2d at 1344. We doubt, however, that piercing between \(D\) Corp. and a natural human being who is not a shareholder is ever appropriate.
State law permits the alter ego claim to be asserted by the trustee in pursuing all funds available as section 541 property of the estate. And federal bankruptcy law permits the trustee to recover property on behalf of all creditors for equitable distribution.\textsuperscript{216} But the court strayed from the path in asking "whether this alter ego action is property of the debtor or \([C_i]\)."\textsuperscript{217} This is inconsistent with the court's earlier statement that the issue was whether SH's property was \(D\) Corp. property:

We now find that, [under relevant state law] a bankruptcy trustee can bring an alter ego claim of action. State law permits the alter ego claim to be asserted by the trustee in pursuing all funds available as section 541 property of the estate. And federal bankruptcy law permits the trustee to recover property on behalf of all creditors for equitable distribution.\textsuperscript{218}

Once the court unconsciously changed its analysis to locating ownership of a cause of action, it fell back on the particularized/generalized dichotomy.\textsuperscript{219} This is confusing and unnecessary. The dichotomy is completely irrelevant if the issue is whether of SH assets are really \(D\) Corp. assets.

Twenty years later, the Seventh Circuit further muddied the waters in \textit{Levey v. Systems Division, Inc. (In re Teknek, LLC)},\textsuperscript{220} a fiendishly complex case involving dueling courts and numerous related entities, only one of which was bankrupt. The Seventh Circuit was led astray by supposing that veil piercing is a cause of action, not a fact in the world (identical personhood) to which \(T\) could refer.\textsuperscript{221}

\(C_i\) had sued two sibling entities, Teknek LLC. (\(D\) Corp.), and Teknek Electronics (\(E\) Corp.) for patent infringement in California federal court. The two sibling companies were wholly owned by two individuals (the \(SH\)). During the California litigation, the \(SH\) caused the two sibling entities to transfer their assets to a third subsidiary, Teknek Holdings (\(H\) Corp.) thereby render-
ing D Corp. and E Corp. insolvent. After winning its joint and several infringement suit against D Corp. and E Corp., C, also obtained judgment against the SH and H Corp. as the alter egos of both D Corp. and E Corp.\textsuperscript{222} D Corp. thereafter filed for bankruptcy in Illinois.\textsuperscript{223} In the Illinois proceeding, T brought a claim against SH and E Corp. (but not against H Corp.) on a number of grounds including fraudulent transfer and alter ego.

C, and SH sought to stay T's adversary proceeding because C, was trying to negotiate a settlement in the California proceeding. The bankruptcy court instead enjoined C, from enforcing the California judgment on the ground that the piercing causes of action were property of the bankruptcy estate.\textsuperscript{224} Properly speaking, the bankruptcy court was right for the wrong reason. Piercing is not a cause of action. Piercing establishes that SI's property is D Corp.'s property. The automatic stay protects SH's property because SH and D Corp. are the same person.

After the bankruptcy court's injunction, the California settlement conference was canceled and T filed a motion in the Illinois bankruptcy court seeking to settle the claims. In a stunning example of judicial tit for tat, the California federal court issued a sanction order purporting to nullify the bankruptcy injunction.\textsuperscript{225} The Illinois courts apparently ignored the California court order.

While the bankruptcy court considered T's settlement proposal,\textsuperscript{226} C,  

\textsuperscript{222}Id. at 642. The Federal Circuit Court of Appeals upheld this judgment. Id.

\textsuperscript{223}E Corp. entered into insolvency proceedings in the United Kingdom. Sys. Div., Inc. v. Teknek Eleca, Ltd., 253 Fed. App'x. 31 (D.C. Cir. 2007). This does not seem to have affected the analysis of any American courts.

\textsuperscript{224}Teknek, 563 F.3d at 642. Judge Cudahy for the Seventh Circuit complained of imprecision in the bankruptcy court's injunction, but introduced a new confusion into the analysis:

The bankruptcy court's injunction order does not carefully distinguish between [D Corp.] and [E Corp.] Although it acknowledges that [C,]'s patent suit was against both [D Corp.] and [E Corp.], and that [C,] sought to add [the SH] and [H Corp.] as defendant on an alter ego theory, the bankruptcy court states that the judgment in the patent suit is only against [D Corp]. The bankruptcy court's order omits any mention at all of [E Corp.]'s joint and several liability on the patent judgment. Also omitted is the California district court's order ruling that [the SH] and [H Corp.] are equally on the hook for the liability of E Corp. as they are for the liability of [D Corp.]. The order indicates that [D Corp.] is the only entity directly liable for the patent judgment. If this were the case, [C,] would have been properly enjoined from pursuing its claim, as it would have been a claim against [D Corp.] reserved for the bankruptcy trustee.

\textsuperscript{225}Id. at 643. We can't figure out what it means that C,,'s claim against D Corp. is "reserved for the bankruptcy trustee." C,,'s claim is a proof of claim, which the trustee is obligated to pay consistent with the distribution rules of the Bankruptcy Code.

\textsuperscript{226}Id. at 644 ("Then the California federal court issued a sanctions order purporting to nullify the bankruptcy court's preliminary injunction . . . ").

\textsuperscript{226}Bankruptcy courts are required to approve any settlement T reaches in suits against third parties. See Fed. R. Bankr. P. 9019.
appealed from the Illinois bankruptcy court's injunction against the California proceedings. The Illinois district court found that the piercing "cause of action" belonged to \( C_1 \).227 Somewhat separately, the district court observed that \( C_1 \) was basically \( D \text{ Corp.}'s \) only (non-insider) creditor,228 and permitting a settlement outside bankruptcy would do no real harm. The district court also observed that, if \( C_1 \) took \( SH \) assets in a California settlement, there would still be enough left over for \( SH \) to cover \( T \)'s fraudulent transfer claims against \( SH \).229

The Seventh Circuit upheld the district court but contested much of its reasoning.230 Judge Cudahy discounted the fact that \( C_1 \) was basically \( D \text{ Corp.}'s \) only creditor and that settling in California was basically not in contradiction with the Illinois bankruptcy case. Rather, what counted was the fact that \( C_1 \) had a joint and several claim for patent infringement against \( D \text{ Corp.} \) and a nondebtor, \( E \text{ Corp.} \). But Judge Cudahy had forgotten that the nondebtor in question (\( E \text{ Corp.} \)) was (according to \( T \)'s adversary proceeding) the same person as \( D \text{ Corp.} \).

The result overlooks the fact that \( C_1 \) was pursuing \( SH \) assets, which were really \( D \text{ Corp.} \) assets. Furthermore, since \( T \) has seeking a horizontal piercing between \( D \text{ Corp.} \) and \( E \text{ Corp.} \), \( C_1 \)'s claim against \( E \text{ Corp.} \) was also a claim against \( D \text{ Corp.} \), and the automatic stay prevented its enforcement altogether.

In short, one may assert the mathematical property of transitivity between identities. If \( D \text{ Corp.}=SH \text{ and } SH=E \text{ Corp.} \), then \( D \text{ Corp.}=E \text{ Corp.} \).

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227 Teknek, 563 F.3d at 641 ("the district court found that \([C_1]'s\) alter ego claims were neither property of the estate nor related to the bankruptcy proceeding. It therefore ruled that \([C_1]'s\) claims were not subject to the automatic stay . . . ."), see also id. at 643-44 ("The district court in Chicago vacated the preliminary injunction, finding that the bankruptcy court lacked jurisdiction to enjoin \([C_1]'s\) settlement with the alter egos. The district court concluded that the automatic stay . . . did not extend to \([C_1]'s\) claim. The court reasoned that \([C_1]'s\) claim was personal to it and independent of any claim a hypothetical general creditor could have brought against \([D \text{ Corp.}]\). Therefore the claim was not property of the estate, and not covered by the automatic stay"). The point seems to be that \( C_1 \) had a claim for patent infringement against \( E \text{ Corp.} \) that was not dependent on piercing a corporate veil. Therefore, \( C_1 \) could enforce that claim against \( E \text{ Corp.} \) free and clear of the automatic stay. But this ignores the fact that, according to \( T \), \( E \text{ Corp.} \) and \( D \text{ Corp.} \) are the same person. On this premise, pursuing \( E \text{ Corp.} \) outside of bankruptcy violated the automatic stay.

228 It seems that \( D \text{ Corp.} \) had almost no assets of its own: Its petition listed them as worth \$73.22.
Fisher v. Hamilton (In re Teknek, LLC), 343 B.R. 850, 856 (Bankr. N.D. Ill. 2006). Moreover, the value of the assets that \( D \text{ Corp.} \) had transferred to \( H \text{ Corp.} \) were also negligible in value, so that the estate would not be materially enhanced by a fraudulent transfer recovery against \( H \text{ Corp.} \). Consequently, the only way to increase the estate would be to absorb the assets of the wealthy \( SH \). In addition, the only non-insider creditor of \( D \text{ Corp.} \) was \( C_1 \) under its patent infringement judgment. The petition listed liabilities of \$3,788,609.57, of which \$3,700,000 (\$97.66%) was claimed by \( C_1 \). The remaining claim seems to have been filed by the sibling \( H \text{ Corp.} \) Id. at 856.

229 Teknek, 563 F.3d at 644.

230 Id. at 642. Judge Cudahy disagreed with the district court's use of "particularized creditor rights."

231 Technically, \( T \) would have to pierce up to the \( SH \) and then reverse pierce down to \( E \text{ Corp.} \).
C₁ violates the stay by pursuing either SH assets or E Corp. assets. However, since T had not pursued H Corp. assets on veil piercing grounds, C₁ could have continued with its action against H Corp.²³²

While the appeal was pending, the bankruptcy court approved T's motion to compromise all of its claims against the alter egos. This should have been a satisfying practical result regardless of which court ultimately had jurisdiction and whatever theory one adopted as to piercing. Judge Cudahy found that settling before he could rule that C₁ alone could pursue the assets of the SH violated the general principle that a lower court loses jurisdiction over a case pending the appeal.²³³ Judge Cudahy sanctioned each of T and C₁ $5,000 for acting prematurely, even though the parties anticipated what he was going to do—permit the California settlement to proceed.²³⁴

At this point, we scratch our head and ask what is really going on in this case. The SH spent years trying to avoid liability - stripping D Corp. and E Corp. of their assets, and litigating under various theories in multiple courts. Eventually, SH apparently decided to throw in the towel and pay the infringement judgment in full to C₁. Since there were apparently no other non-insider creditors they should have been able to settle all claims in all courts regardless of the procedural niceties.

One of the earlier opinions gives a hint as to what was really at stake - an issue ignored by the Seventh Circuit.²³⁵ The true issue was not what claimants collected, but who was to receive the legal fees.²³⁶ If C₁ was permitted to enforce its judgment outside of bankruptcy, C₁ would retain the entire recovery and C₁'s lawyer would get paid. If, however, the judgment was recovered in bankruptcy, where C₁ was basically the only claimant, T would receive a 25 percent contingency fee prior to distribution to C₁. Put this way, the case seems less about the appropriate forum for litigating alter

²³²The district court recognized this:

Because the district court in Chicago agreed with the California federal court's finding that [D Corp.] had transferred all of its assets directly to [H Corp.], instead of to [E Corp.], the court also concluded that there was no need for the bankruptcy court to untangle [D Corp.'s] assets from [E Corp's] assets, obviating that basis for related-to jurisdiction. The court also focused on the fact that [C₁] was [D Corp.'s] only major creditor: allowing [C₁] to settle its claim outside bankruptcy would not impair the recovery of a larger class of creditors, so the primary function of [T]—to maximize recovery on behalf of creditors as a whole—was not implicated.

Teknek, 563 F.3d at 644.

²³³Id. at 650.

²³⁴Id. at 651-52.


²³⁶Id. at 957 ("The Trustee failed to articulate any reasonable basis for the appeal other than the hope of a contingency fee recovery. We thus order that sanctions be imposed on the Trustee and on his attorneys, jointly and severally.").
ego claims, and more about whether $T$ could obtain the fees for helping $C_1$ recover on its patent infringement claim.

6. *Piercing in the Supreme Court*

In some circuits, piercing the corporate veil is conceived as a cause of action that belongs to $C_1$, not to $T$. But the Supreme Court decided otherwise 85 years ago in the forgotten case of *Steelman v. All Continent Corp.* The case implies our theory that, in a true piercing case—in *Steelman*, a reverse piercing case—the assets of $D \text{ Corp.}$ are the assets of $S H$.

In *Steelman*, $D$, an individual, was in dutch with his creditors. Seeking to hinder them, $D$ formed $S \text{ Corp.}$, to which $D$ transferred substantial assets, including valuable shares of $Z \text{ Corp}$, which shares were placed in the custody of a Philadelphia stockbroker. Thereafter, $D$ transferred the shares of $S \text{ Corp}$ to his wife and children.

$C_1$ then obtained a judgment against $D$ in the Southern District of New York. $C_1$ served a restraining notice on the broker prohibiting the broker from disposing of the $Z \text{ Corp.}$ shares. Accordingly, the broker refused $S \text{ Corp.}$ instructions to transfer these shares, "having notice of the claim that, irrespective of the form of the account, the securities belonged to [D]." At this point, $D$ filed for bankruptcy in New Jersey.

$D \text{ Corp.}$ then brought an action in the district court for the Eastern District of Pennsylvania against $C_1$, the broker. $D$'s family, and $D$'s bankruptcy trustee ($T$), seeking a declaration that $D \text{ Corp.}$ owned the $Z \text{ Corp.}$ shares free and clear of these other entities. $T$ obtained from the New Jersey district court a stay of the Pennsylvania action. $T$ then left the New Jersey district court and sued $D$, $D$'s family and $D \text{ Corp.}$ in the New Jersey chancery court charging fraud in the opening of accounts with stockbrokers, ostensibly for the use of [$D \text{ Corp.}$] itself, but really for the use of [$D$] alone. All these transactions are stated to have occurred in execution of a unitary scheme, to which [$D$, his wife and children and $D \text{ Corp.}$] were parties in its several manifestations, for the hindrance of creditors in the enforcement of their rights and remedies. A decree is prayed enjoining the corporation from disposing of its assets, appointing a receiver to manage and preserve them during the pendency of the suit, annulling all the transfers tainted by the fraud, and de-

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237 U.S. 278 (1937).

238 Id. at 282.
crearing a trust for the benefit of the bankrupt and through him for the trustee.\textsuperscript{239}

$D$ Corp. appealed from the injunction that the New Jersey district court had issued against the Pennsylvania district court. The Third Circuit court of appeals overruled the New Jersey district court on the grounds that “the Pennsylvania court, having first acquired jurisdiction of the property and controversy, is entitled to exclusive jurisdiction . . . “\textsuperscript{240}

The Supreme Court reversed again and reimposed the stay on the grounds that $T$ should control the controversy as part of the New Jersey bankruptcy proceeding. This is the holding that justifies the view that, in piercing cases, property of $S$ Corp. is property of the estate. In modern times, the automatic stay would do the work accomplished by the New Jersey district court’s injunction.

It is not entirely clear from the Steelman opinion what the trustee’s theory was with respect to the $Z$ Corp. securities. Justice Cardozo referred to $T$’s theory as sounding in “a conspiracy to cover up the bankrupt’s assets,”\textsuperscript{241} to fraudulent transfer\textsuperscript{242} and to resulting trust\textsuperscript{243}—$D$ intended to make $D$ Corp trustee of the $Z$ Corp shares for the benefit of $D$. However, read as a whole $T$’s allegation seems to have been that the securities were assets of the bankruptcy estate. Allowing the Pennsylvania case to proceed was seen as “a step in the execution of a fraudulent conspiracy, impeding and perhaps frustrating the administration of the assets.”\textsuperscript{244} $T$ should control the litigation because there was “[p]robable cause for preserving the estate from dismemberment . . .”\textsuperscript{245} and because

[j]urisdiction to administer the estate draws to itself, when once it has attached, an incidental or ancillary jurisdiction to give protection to the estate against waste or disintegration while frauds upon its integrity are in the process of discovery.\textsuperscript{246}

Justice Cardozo cited with approval the New Jersey district court’s remark “that a grave question has arisen as to ownership of the assets and shares of

\textsuperscript{239}Id.

\textsuperscript{240}Id. at 284, quoting All Continent Corp. v. Steelman, 86 F.2d 913, 915 (3d Cir. 1936).

\textsuperscript{241}Steelman, 301 U.S. at 285.

\textsuperscript{242}Id. (referring to $D$ Corp. as “the supposed fraudulent grantee”).

\textsuperscript{243}Id. (“secret trust for the benefit of the bankrupt”). On the mutually exclusive theories of resulting trust and fraudulent transfer, see David Gray Carlson, Giving Back a Fraudulent Transfer: A Defense to Liability?, 40 AM. BANKR. L.J. 629, 630-31 (2020).

\textsuperscript{244}Id. at 285.

\textsuperscript{245}Id. at 288.

\textsuperscript{246}Id. at 289.
Steelman, then, implicitly agrees that, when it comes to piercing veils, piercing is not a cause of action belonging to T. Piercing stands for the proposition that the assets ostensibly belonging to D Corp. in fact belong to D. Consequently, the action brought by T were ordinary attempts to martial D's property under the auspices of bankruptcy jurisdiction.

That Steelman is a veil piercing case is demonstrated in a subsequent Third Circuit opinion arising from the same bankruptcy. Upon T's request, the New Jersey district court ordered D Corp. to turn over all its books and records to T. The Third Circuit, however, reversed on the grounds that D Corp. was a third party not subject to the bankruptcy. Part of the concern, however, centered on the now archaic procedural distinction in the 1898 Bankruptcy Act. In those days, a bankruptcy referee had summary jurisdiction over property actually in the debtor's possession. If property was possessed by a third person, the bankruptcy trustee had to leave bankruptcy court and sue a third party in some other court, which was said to have "plenary" jurisdiction over T's attempt to marshal assets. Referring to this distinction, the Third Circuit stated:

Of course, this [i.e., collecting D Corp.'s books and records] could be done if it were established that the appellant belonged to the bankrupt and was simply his alter ego, but this could be established only by a plenary suit. The error of the referee was the assumption that this was a fact and then proceeding as though the fact had been established.

In other words, the Third Circuit agreed that if D Corp. were D's alter ego, then D Corp.'s property—in this case, its books and records—would be the property of D's bankruptcy estate. Implicitly, the trustee could then use, sell or lease such records. The problem was that, in the 1930s, a declaration that D Corp. was D's alter ego fell outside the referee's summary jurisdiction (or so it seemed for the moment). Rather, the trustee needed to bring a full blown "plenary trial" before a state or federal nonbankruptcy court. In any event, the Third Circuit agreed with us that it is T who gets to litigate the issue of piercing (or, here, reverse piercing). The ultimate issue is whether D Corp. assets are D's assets (because D and D Corp. are the same person). In reaching this conclusion, none of the courts in Steelman made any appeal to generalized creditor rights.

The Supreme Court returned to veil piercing in Sampsell v. Imperial Pa-

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247 Id. at 282-83, citing In re Fox, 96 F. Supp. 949 (D.N.J. 1936).
248 In re Fox, 96 F.2d 20, 21-22 (3d Cir. 1938).
249 To use the modern parlance found in Bankruptcy Code § 363(b).
In this case, D was, once again, in dutch with his creditors. D formed D Corp. and made himself, wife and son the shareholders. D then "bulk sold" to D Corp. his business assets for credit. Later, D Corp. satisfied this debt by issuing more shares to D and family. A creditor (C) extended unsecured credit to D Corp. Later, D was bankrupt. T sought a declaration that D Corp.'s assets were property of D's bankruptcy estate. According to Justice William O. Douglas:

The referee found, inter alia, that the transfer of the property to the corporation was not in good faith but was made for the purpose of placing the property beyond the reach of [D's] creditors...; that the corporation was "nothing but a sham and a cloak" devised by [D] "for the purpose of preserving and conserving his assets" for the benefit of himself and his family, and that the corporation was formed for the purpose of hindering, delaying and defrauding his creditors. The referee accordingly ordered that the property of the corporation was property of the bankrupt estate and that it was to be administered for the benefit of the creditors if the estate.

Thus, the referee relied on inconsistent theories. First, D's conveyance to D Corp. was a fraudulent transfer. But this was not within the court's summary jurisdiction. Fraudulent transfers were plenary matters bringable only in some other court. Second, the referee pierced the corporate veil, which is in fact a theory inconsistent with fraudulent transfer. A fraudulent transfer presupposes that D (the transferor) and D Corp. (the transferee) are two separate persons. Veil piercing presupposes that D and D Corp. are the same persons. If they are the same persons, D Corp.'s property is D's property and therefore within the referee's summary jurisdiction. Thus, properly, the referee was piercing the veil, because only that action was within the referee's competence.

C then intervened in the bankruptcy to claim that C had "priority" as to D Corp.'s assets. T acknowledged that C was a creditor in D's bankruptcy, which coheres with the piercing theory—the creditors of D Corp. are creditors of D. But T denied that C was a secured creditor. C, however, won

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250114 F.2d 49 (9th Cir. 1940), rev'd 313 U.S. 215 (1941).
252Sampsell, 313 U.S. at 216-17.
255Imperial Paper & Color Corp. v. Sampsell, 114 F.2d 49 (9th Cir. 1940), rev'd 313 U.S. 215 (1941).
the day in the Ninth Circuit.256

The Supreme Court reversed.

There can be no question but that the jurisdiction of the bankruptcy court was properly exercised by summary proceedings. The circumstances are many and varied where an affiliated corporation does not have, as against the trustee of the dominant stockholder, the status of a substantial adverse claimant . . .257

Thus the Supreme Court recognized that the bankruptcy court had access to the piercing theory.

There is in Sampsell some unfortunate language suggesting that Justice Douglas, a bankruptcy expert, did not quite grasp the difference between a fraudulent transfer theory (beyond the competence of a bankruptcy referee) and a piercing theory (within the competence of the referee):

But in this case there was a fraudulent transfer. The saving clause in 13 Eliz. which protected innocent purchasers for value was not broad enough to protect mere unsecured creditors of the fraudulent transferee. To be sure, creditors of a fraudulent transferee have at times been accorded priority over the creditors of a transferor where they have “taken the property into their own custody.” The same result obtains in case of bona fide lien creditors of the fraudulent transferee. . . . Yet none of these considerations is applicable here . . . [C] is neither a lien creditor nor an innocent grantee for value . . . And title to the property fraudulently conveyed has vested in the bankruptcy trustee of the grantor . . . [C] therefore is entitled only to pari passu participation with [D’s] individual creditors.258

These references to fraudulent transfers should be read as an adjunct to piercing the veil. That is, piercing was justified in part because D used this alter

256 The theory of the Ninth Circuit appeared to be that the veil between D Corp. and D should not be pierced, because that would cause an injustice to C. T therefore had basically stolen D Corp.’s assets and held these in trust for C (or C “should be accorded priority,” as the Ninth Circuit put it. Sampsell, 114 F.2d at 52-53. This ignores the ancient principle that the unsecured creditors of D Corp. have no property interest in D Corp.’s assets. Grupo Mexicano de Desarrollo v. Alliance Bond Fund., 527 U.S. 308, 319-20 (1999) (“[A] general creditor (one without a judgment) had no cognizable interest, either at law or in equity, in the property of his debtor, and therefore could not interfere with the debtor’s use of that property.”).

257 Sampsell, 313 U.S. at 218. A substantial adverse claim would have expelled the matter from the referee’s summary jurisdiction. Taubel-Scott-Kitzmiller Co v. Fox, 264 U.S. 426 (1924) (sheriff’s possession ousted the case from summary jurisdiction).

258 Sampsell, 313 U.S. at 220-21 (citations and footnote omitted).
ego to park his property in the hopes that his creditors would not get it. Fundamentally, Sampsell is a piercing case because only piercing was within the competence of the referee.

More recently, Chief Justice John Roberts adopted our approach to veil piercing in his dissent in Wellness International Network, Ltd. v. Shariff. In Wellness, C had claims for attorney’s fees against D arising from abusive behavior by D when D sued C on a grievance. C filed a proof of claim in D’s bankruptcy and objected to D’s bankruptcy discharge. In connection therewith, C sought a declaration that property of a trust was actually property of the bankruptcy estate—a veil piercing claim. Ordinarily, the bankruptcy trustee would sponsor such an initiative, but here C took the laboring oar on behalf of the bankruptcy estate, no doubt because the facts justifying denial of discharge also justified piercing the veil.

D refused to cooperate with discovery and so, as a sanction, the bankruptcy court issued a default judgment on the question of bankruptcy discharge and also on the question of piercing the veil. D appealed to the district court. Before that appeal could be heard, the Supreme Court handed down its decision in Stern v. Marshall, which held that a creditor in a bankruptcy had the right to an Article III adjudication with regard to a tort counterclaim. In Wellness, D did not mention Stern in his initial brief. Later, D asked for permission to file new briefs to claim that he was entitled to an Article III adjudication of piercing the veil. The district court denied permission, ruling that D had waived his Stern rights by waiting too long.

The Seventh Circuit, however, reversed. It held that the bankruptcy court could enter judgment against discharge of debt. These actions were governed by federal law. But the veil piercing claim was held to be a Stern claim. Furthermore, the Seventh Circuit thought, the Stern right was incapable of being waived.

On further appeal to the Supreme Court, per Justice Sonia Sotomayor, ruled that the Stern right could be waived. The court remanded the case for determination whether the Stern right had indeed been waived. Although at first blush this might seem to suggest that the Supreme Court majority had rejected our theory that alter ego is not a claim. But this is not the case. Justice Sotomayor stated that, because the majority found “the Bankruptcy Court could validly enter judgment on [D’s] claim with parties’ consent, this opinion did not address, and expresses no opinion on, [D’s] alternative contention that the Seventh Circuit erred in concluding the claim was a Stern claim.”

261 Wellness, 575 U.S. at 772 n.7. The Seventh Circuit Court of Appeals, in finding that the alter ego
Justice Roberts strongly protested. Viewing waiver of the Stern right as unconstitutional, he argued that the majority need not have reached the issue of whether consent justified an Article I adjudication of the piercing claim. Rather, piercing was within the purview of what an Article I bankruptcy judge could accomplish without any reference to Stern: "Defining what constitutes the estate is the necessary starting point of every bankruptcy; a court cannot divide up the estate without first knowing what's in it." 262

Furthermore, Justice Roberts distinguished between alter ego (he unfortunately refers to it as a "claim") and a fraudulent transfer claim in the same fashion as we have urged:

Although both actions aim to remedy a debtor's deception, they differ in a critical respect. A fraudulent conveyance claim seeks assets in the hands of a third party, while an alter ego claim targets only the debtor's "second self". That distinction is significant given bankruptcy's historic domain over property within the actual or constructive "possession of the bankrupt at the time of the filing of the petition". Through a fraudulent conveyance, a dishonest debtor relinquishes possession of assets before filing for bankruptcy. Reclaiming those assets for the estate requires depriving third parties of property within their otherwise lawful possession and control, an action that "quintessentially" required a suit at common law. By contrast, a debtor's possession of property provided an "adequate basis" for a bankruptcy referee to adjudicate a dispute over title in a summary proceeding. 263

Thus, Chief Justice Roberts found that piercing was within the "summary jurisdiction" of the bankruptcy court. 264 Significantly, he reached this correct issue must be decided by an Article III judge, analyzed it as a claim by C, "indistinguishable from the tortious-interference claim in Stern..." Wellness Intern. Network, Ltd. V. Sharif, 727 F.3d 751, 756 (7th Cir. 2013). That is, it is a claim under state law that "is in no way derived from or dependent upon bankruptcy law... that exists without regard to any bankruptcy proceeding." Id. quoting Stern, 564 U.S. at 490.

262 Wellness, 575 U.S. at 692.

263 Id. at 694 (citations omitted). Chief Justice Roberts was historically inaccurate in stating that fraudulent transfer recoveries were brought at law. In fact this never occurred anciently. If a court was involved at all, it was in chancery, by means of a creditor's bill in equity after the creditor had a money judgment from a court of law. See David Gray Carlson, Fraudulent Transfers and Juries: Was Granfinanciera Rightly Decided?, 95 Am. Bankr. L.J. 209 (2021).

264 Justice Roberts, however, includes an important contingency. Piercing falls within the old concept of summary jurisdiction "so long as no third party asserted a 'substantial adverse' claim." Wellness, 575 U.S. at 693. Chief Justice Roberts invited the bankruptcy court on remand to find whether such a third party claim existed to deprive the bankruptcy court of jurisdiction. Thus, if the beneficiaries of the trust (for which D served as trustee) had appeared to assert the reality of the trust, then perhaps piercing would have constituted a Stern claim. This does not make a lot of sense. A bankruptcy judge may pierce unless
reasoning without any reference to generalized v. particularized creditor rights.

7. Overlaps between Fraudulent Transfers and Veil Piercing

We have alluded to the fact that piercing the veil potentially overlaps (and conflicts) with a claim of fraudulent transfer. Suppose D Corp. transfers a gold brick to P Corp. with intent to hinder the Cg. C1 can get a lien on the brick by alleging the transfer was fraudulent. Or C1 can get a lien on the brick (and other P Corp. assets) by piercing veils.265 The very fact of the fraudulent transfer can be evidence that the veil ought to be pierced. The same end is achieved: C1 liens the brick. For this reason, C1 routinely pleads fraudulent transfer and alter ego as separate (and mutually contradictory) theories.266 The same goes for D Corp.'s bankruptcy trustee.267

C1 or (if bankruptcy ensues) T must choose between the inconsistent theories of fraudulent transfer and piercing. Both can't be true at the same time. What if T chooses the fraudulent transfer theory and neglects to pierce the veil? The brick is liquidated and distributed to the Cg. But T forgoes the other assets of P Corp. The case is closed and the stay ends. May C1 garnish P Corp.'s "other assets" on a veil piercing theory?

In Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.),268 D Corp. sold assets to X Corp. A class of tort victims injured by D Corp. (the Cg) sued X Corp. on a piercing theory. D Corp. went bankrupt and T sued X Corp. for fraudulent transfers—over $5 billion worth. T triumphed in bankruptcy court, winning summary judgment in an amount to be determined, but said to be between $5 and $14 billion.270 X Corp. settled for the bargain rate of $5 billion. As part of the settlement, T agreed to release all claims controlled by T against X Corp., and the district court issued "an injunction barring the litigation of claims that are derivative or duplicative of [D Corp.]'s claims..."
against [X Corp.].”271 The claims of the C_v were disposed of in a confirmed chapter 11 plan.

Soon after, C_v renewed its suit against X Corp. in state court on the veil piercing theory—that the tortious acts of D Corp. were the acts of X Corp. and that the C_v was entitled to judgment against X Corp. Pursuit of the veil piercing theory was exceptionally problematic. Both D Corp. and X Corp. scrupulously observed the corporate formalities. When these formalities are honored, piercing rarely (perhaps never) follows.272 But the C_v figured they deserved its day in court. Perhaps the very fact of the suit would have “strike” value, causing a settlement for less than the expected cost of the defense. Perhaps a jury or state court judge would do something crazy.

Rather than pleading the settlement as a defense in state court, X Corp. scurried to bankruptcy court for an order enjoining X Corp. from pursuing the veil piercing theory against X Corp. The bankruptcy court issued the desired order and, on appeal, the Second Circuit declared that the C_v were asserting generalized creditor rights which belonged solely to T.273 “[T]he claims were derivative and therefore property of the [D Corp.] estate.”274 T had settled all general creditor claims against X Corp. The C_v had no right to bring a generalized creditor right against X Corp.

We submit that reference to the derivative nature of creditor rights was unnecessary to this correct result. Prior to bankruptcy, C_v could and did bring a products liability action against X Corp., based on the identity of X Corp. and D Corp. Bankruptcy apparently terminated that right.275 Why did bankruptcy law extinguish C_v’s right?

One answer on the Tronox facts (not asserted in the court opinions) is that, on the logic of the C_v, D Corp. and X Corp. were the same person. D Corp. had been discharged in the chapter 11 proceeding.276 Therefore, X Corp. was discharged. True, Bankruptcy Code § 524(e) provides that “dis-

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271Id. at 88. According to the injunction:

(ii) any creditor of [D Corp.] who filed . . . a claim in the Chapter 11 Cases, (iii) any other Person whose claim (A) in any way arises from or is related to the Adversary Proceeding, (B) is a Trust Derivative Claim, or (C) is duplicative of a Trust Derivative Claim . . . is hereby permanently enjoined from asserting against [S Corp.] (I) Any Trust Derivative Claims or (II) any claims that are duplicative of Trust Derivative Claims, whether or not held or controlled by the Litigation Trust, or whether or not the Litigation Trust could have asserted such claims against [X Corp.] The injunction herein shall not apply to or bar . . . any liability that [X Corp.] might have that does not arise from or through a liability of [D Corp.].

Id. at 92.

272See supra text accompanying notes 107-10.

273Tronox, 55 F.3d at 94.

274Id. (quoting the district court).

275So we may infer from the Tronox result.

276Id. at 104.
charge of a debt of the debtor does not affect the liability of any other entity..." but, by C's own logic, X Corp. is not another entity. It is the same entity.

This answer is limited to chapter 11 cases, where corporations are entitled to discharges. In chapter 7 cases, corporations are never entitled to a discharge. What would have happened in Tronox had it been a chapter 7 liquidation? The answer lies in res judicata. T sued for avoidance of a fraudulent transfer. Such a theory depends upon the separate personhood of D Corp. and X Corp. T and X Corp. settled, and the bankruptcy court approved the settlement. This amounts to an implicit judicial finding of separate personhood. Since T represented the C's, the C's were bound by the settlement. C's ground for piercing was the fraudulent transfer of assets. But in settling with T, X Corp. essentially bought back the assets from D Corp. What was fraudulent was purged of wrongfulness by the baptism of purchase. Therefore, given the transfers were retrospectively not fraudulent (thanks to the settlement), grounds for piercing the veil had evaporated.

But this was not the grounds that the Second Circuit relied upon. The court assumed that C's claim was "derivative"—that is to say, a generalized creditor right which passes from C to T when D Corp. filed for bankruptcy. Citing Marshall v. Picard (In re Bernard L. Madoff Inv. Secs. LLC), the Tronox court defined derivative claims as ones that "arise from harm done to the estate and that 'seek relief against third parties that pushed the debtor..."
into bankruptcy.\textsuperscript{285}

So defined, "derivative" fits poorly with veil piercing. In \emph{Tronox}, veil piercing \emph{enhances} \emph{D Corp.'s} estate. It does not seek redress from harm done to the estate. Confusingly, \emph{X Corp.} took fraudulent transfers from \emph{D Corp.} and \emph{that} harmed the estate. And those fraudulent transfers were cited as grounds to pierce the veil. But veil piercing doesn't \emph{just} recompense the estate for the fraudulently transferred stuff. It \emph{enhances} the estate by expropriating \emph{all} of \emph{X Corp.'s} assets.

The overlap of fraudulent transfer and veil piercing caused similar difficulties in \emph{St. Paul Fire \\& Marine Ins. Co. v. PepsiCo, Inc.}\textsuperscript{286} In that case, a parent corporation (\emph{P Corp.}) looted \emph{D Corp.} and \emph{this} was grounds to pierce the veil. \emph{C\textsubscript{1}} sued \emph{P Corp.} The district court ruled that piercing was not appropriate on the facts. When \emph{C\textsubscript{1}} appealed, the Second Circuit sua sponte held that \emph{D Corp.'s} bankruptcy trustee owned piercing rights. Therefore \emph{C\textsubscript{1}} had no "standing" to sue \emph{P Corp.} The court also spoke of \emph{C\textsubscript{1}}'s theory as relating to the recovery of looted assets. Thus \emph{C\textsubscript{1}} "alleged a secondary effect from harm done to [\emph{D Corp.}] by [\emph{P Corp.}]-removing assets from [\emph{D Corp.}] that would have allowed [\emph{D Corp.}] to meet its obligations to [\emph{C\textsubscript{1}}]."\textsuperscript{287} But piercing not only restores the loot but \emph{enhances \emph{D Corp.'s}} estate because piercing adds \emph{extra} assets of \emph{P Corp.} to \emph{D Corp.'s} estate.

Incidentally, the Second Circuit did precisely what the Supreme Court \emph{should} have done in \emph{Husky International Electronics v. Ritz.}\textsuperscript{288} In \emph{Husky}, \emph{C\textsubscript{1}} had a contract claim against insolvent \emph{D Corp.} \emph{X}, a shareholder and corporate officer of \emph{D Corp.}, stole funds from \emph{D Corp.} and wired the funds to \emph{X Corp.}, of which \emph{X} was a shareholder. \emph{D Corp.} filed for bankruptcy and \emph{X} separately filed for bankruptcy. \emph{C\textsubscript{1}} filed a claim in the \emph{X} bankruptcy based on veil piercing. \emph{C\textsubscript{1}} characterized the theft as a fraudulent transfer. It objected to \emph{X}'s bankruptcy discharge of \emph{C\textsubscript{1}}'s contract claim because \emph{X Corp.} had received a fraudulent transfer. The case is confusing because none of the courts was clear whether \emph{C\textsubscript{1}} was piercing the \emph{X-D Corp.} veil or the \emph{X-X Corp.} veil. At any rate, a veil was pierced. The Supreme Court assumed that \emph{C\textsubscript{1}} had this right against \emph{X}—that \emph{C\textsubscript{1}}'s right was a particularized creditor right that \(T_{DC}\) (of \emph{D Corp.}) did not own. The Supreme Court simply overlooked the fact that the right to pursue \emph{X} for the stolen loot or for the fraudulently transferred loot or for \emph{X}'s general assets on a piercing theory belonged to \(T_{DC}\)—not to \emph{C\textsubscript{1}}. Nevertheless, \emph{Husky} certainly is consistent with the idea

\textsuperscript{285}\emph{Tronox}, 855 F.3d at 100.
\textsuperscript{286}84 F.2d 688 (2d Cir. 1989).
\textsuperscript{287}Id. at 704.
\textsuperscript{288}136 S. Ct. 1581 (2016).
that piercing rights reside with the \( C_g \), not with \( T_{DC} \). With respect, we beg to differ.

In short, in cases involving the overlap of fraudulent transfer and veil piercing, \( T \) has exclusive right to these theories. Accordingly, any action by \( T \) to settle the fraudulent transfer claims also constitutes a settlement of the piercing claim in that \( T \) admits the separate personhood of \( X \) when \( T \) settles fraudulent transfer claims. On this basis, we conclude that the literal terms of the settlement in \textit{Purdue Pharma}\textsuperscript{289} were well within the traditional bankruptcy jurisdiction. The settlement covered these claims.\textsuperscript{290} It also covered breach of fiduciary duty claims, which belonged solely to the debtor-in-possession. These two could be settled, and the settlement could be protected by a channeling injunction,\textsuperscript{291} since the fraudulent transfer and fiduciary duty claims were property of the bankruptcy estate.\textsuperscript{292} We note that Judge Drain unnecessarily invoked the generalized/particularized dichotomy,\textsuperscript{293} of which we disapprove.

Unfortunately, Judge Drain read the plan as condoning expropriation of creditor rights against \( X \) for acts by \( X \) that were independently tortious against the \( C_v \). He reaches this conclusion by expanding the definition of "derivative" beyond its proper scope. His reading, though wrong, is sophisticated and challenging. It bears careful analysis, which we provide elsewhere.\textsuperscript{294}

One last issue remains. Where \( T_{DC} \) never pursues and abandons an overlapping fraudulent transfer and piercing theory, \( C_t \) is invited to pursue either theory after \( D \) Corp.'s bankruptcy case is closed. In \textit{CBS, Inc. v. Folks (In re


\textsuperscript{290}We provide vigorous documentation of this claim in Schroeder & Carlson, \textit{Third Party Releases}, supra note 6.

\textsuperscript{291}The third-party claims that the plan would release and enjoin are very closely related on the facts to the estates' claims for alter ego, veil piercing and breach of fiduciary duty . . . ." \textit{Purdue Pharma}, 633 B.R. at 95. On channeling injunctions, see \textit{In re Aegean Marine Petroleum Network, Inc.}, 599 B.R. 717, 720 (Bankr. S.D.N.Y. 2019):

\textit{[A] Bankruptcy Court is asked to enforce a debtor's own releases by issuing an injunction that prevents third parties from asserting claims that belonged to the estate and that were released by the debtor, and the Plan in the case includes such an injunction. These are sometimes described as third-party releases or as injunctions against third-party claims, but that is not really an accurate characterization of what they are. Injunctions of this kind are more properly described as injunctions against interference with a debtor's court-approved decisions about the disposition of claims that belonged to the debtor . . . Injunctions of this kind do not take away claims that belong to third parties; they just enforce the debtors' releases of the debtor's own claims.}\textsuperscript{292}


\textsuperscript{293}\textit{Id.}\textsuperscript{294}Schroeder & Carlson, supra note 6.
 Folks, C\textsubscript{1} had a claim against D Corp. D Corp. was put into bankruptcy. D Corp.'s owners (SH) soon filed for bankruptcy. In the D Corp. bankruptcy, C\textsubscript{1} moved that T\textsubscript{DC} abandon all claims to piercing. D Corp.'s bankruptcy court granted the motion. C\textsubscript{1} then filed a claim in the SH bankruptcy for its claim against D Corp. on the theory that D Corp. was the alter ego of SH. C\textsubscript{1} then sought to block SH's discharge on its claim.

The bankruptcy court in the SH proceeding ruled that piercing was in the province of T\textsubscript{DC}. But since T\textsubscript{DC} abandoned that theory, C\textsubscript{1} could pursue the theory in the SH bankruptcy. Nevertheless, C\textsubscript{1}'s proceeding to deny SH a discharge failed on statute of limitations grounds. C\textsubscript{1} did file its objection to discharge within the 60-day period provided in the Bankruptcy Rules. But T\textsubscript{DC} did not abandon piercing until after the 60-day period. Since C\textsubscript{1} was not vested with the right to pierce until after the 60-day period, C\textsubscript{1} was too late, and SH was entitled to discharge.

For the record, the case was wrongly decided. T\textsubscript{DC}'s piercing claim was not a cause of action belonging to D Corp. Rather, piercing was the fact in the real world that D Corp. and SH are the same person. Therefore, D Corp.'s bankruptcy and SH's bankruptcy are proceedings for the same person. Since C\textsubscript{1} could file a proof of claim against D Corp., C\textsubscript{1} could file a proof of claim with SH, even though T\textsubscript{DC} had not yet abandoned the piercing theory. Given this right to file, C\textsubscript{1} could also object to discharge of its claim, and so it timely filed after all. Piercing implies that C\textsubscript{1} may not pursue SH assets out of bankruptcy court, as such an action would violate the automatic stay. But C\textsubscript{1} was not pursuing assets outside of bankruptcy. C\textsubscript{1} was seeking bankruptcy court relief to which C\textsubscript{1} was presumptively entitled.

We offer some final observations on the overlap between fraudulent transfer theory and veil piercing. When D Corp. fraudulently transfers a gold brick to its parent P Corp. and D Corp. is bankrupt and P Corp. is not, P Corp. is largely unprotected by the automatic stay against claims by its creditors. Yet the gold brick is property of D Corp.’s bankruptcy estate. Therefore, the gold brick is protected by the automatic stay, but P Corp. is not otherwise protected. Nor are its assets other than the gold brick protected. Where, however, P Corp. is the same person as D Corp., P Corp.’s whole personhood and all of P Corp.’s assets are protected by the automatic stay emanating from D Corp.’s bankruptcy. Thus, in Fisher v. Aposolou, C\textsubscript{1} had

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295 211 B.R. 378 (B.A.P. 9th Cir. 1997).
296 Fed. R. Bankr. P. 4004(a) (60 days).
297 An impediment to this judgment is that the 60-day deadline starts to run with "the first date set for the meeting of the creditors under § 341(a)." Id. We are assuming that, SH's scheduled creditors' meeting does not relate back to D Corp.'s scheduled creditors' meeting.
298 155 F.3d 876 (7th Cir. 1998).
independent claims against X, but X quite possibly had received fraudulent transfers from D Corp. The court issued a preliminary injunction to protect X against C until it was clear that C’s recovery would not affect the assets fraudulently received by X from D Corp.

Where the combined entity is insolvent, the bankruptcy estate absorbs all of P Corp.’s assets. What happens when D Corp. is insolvent but the combined D Corp.-P Corp. estate is solvent? This arose in Koch, Teknek and Tronox. It is entirely natural that T’s property claim to P Corp. assets be reduced to some monetary amount needed to pay the deficit claim of the Cs in the D Corp. bankruptcy. Once P Corp. pays this amount, it buys back its freedom of personhood. Following manumission, it becomes a separate person from D Corp. once again. Under these conditions, piercing, pushed to its limit, evolves into an in personam theory of liability, not an in rem theory.

The same principle should apply to fraudulent transfer cases. Suppose D Corp. fraudulently transfers a very large gold brick to X and subsequently files for bankruptcy. The brick is valuable enough to pay all the Cs in the D Corp. bankruptcy, with value left over. Logically, that value properly belongs to X. But bankruptcy courts disagree. In Tronox v. Anadarko Petroleum Corp. (In re Tronox Inc.), a bankruptcy court ruled that the entire gold brick (or, in this case, its value) had to be given over to T. But this suggests

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299These included RICO claims, which draw treble damages. T has no access to RICO claims, as these never belonged to D Corp.—only to specific creditors who were victimized by racketeering. Ashland Oil, Inc. v. Arnett, 875 F.2d 1271, 1280 (7th Cir. 1989).

300Fisher, 155 F.3d at 182 ("In limited circumstances, the trustee may temporarily block adjudication of claims that are not property of the estate by petitioning the bankruptcy court to enjoin the other litigation, if it is sufficiently 'related to' her own work on behalf of the estate. The jurisdiction of the bankruptcy court to stay actions in other courts extends beyond claims by and against the debtor, to include 'suits to which the debtor need not be a party but which may affect the amount of property in the bankruptcy estate . . . '") (citations omitted).

301This observation explains some otherwise strange language in Levey v. Systems Division, Inc. (In re Teknek, LLC), 563 F.3d 639 (7th Cir. 2009). We won’t repeat the complicated facts here. See supra text accompanying notes 220-36. The court remarks, "The trustee’s complaint also seeks to hold [SH] personally liable for [D Corp.'s] obligation on the judgment to [C] based on an alter ego theory." Id. at 643. How could T subrogate to C’s judgment against SH? The answer is that the combined SH-D Corp. entity was solvent. Furthermore, C was basically D Corp.'s only creditor. Therefore, getting C paid and leaving the SHs' estates otherwise alone make rough sense. Once the SH paid T an amount equaling with C’s judgment against D Corp., T was basically done with the SH. But of course, SH should be made to pay T’s administrative expenses and the amount of the minor creditor claims as well, as SH has to make good all the distributions under Bankruptcy Code § 727(a). See also id. at 645 ("the trustee argues that it can reach the alter egos via [D Corp.] and collect on [C’s] judgment on behalf of the estate . . .").

302See, e.g., Acequia, Inc. v. Clinton (In re Acequia, Inc.), 34 F.3d 800 (9th Cir. 1994) (trustee could recover surplus funds from X); Tronox v. Anadarko Petroleum Corp. (In re Tronox Inc.), 464 B.R. 606 (Bankr. S.D.N.Y. 2012) (same). Acequia seems to be an embezzlement case, not a fraudulent transfer case. If so, D appropriately recovers the full theft, even though D’s creditors have been paid.

D Corp. gets the surplus value at the end of the day, not X. We think that recovery against X should be quantitatively limited to the amount of Cg claims against D Corp.

V. SUCCESSOR LIABILITY

For at least forty years, tort law has been fooling around with successor liability - invented to prevent a dodge by D Corp., where D Corp. is facing massive products liability. Here's the scene that gave rise to successor liability. D Corp. owns a factory that manufactures a product. The product is so defective that it generates predictable tort liability for D Corp. Where a C1 is actually injured, C1 is a creditor of D Corp. and is able to get a money judgment. But future creditors (the Cn) not yet damaged are unable to obtain judgments against D Corp. They are creditors (in the eyes of tort law) only when an injury manifests itself.

D Corp. then sells the factory to a buyer, B Corp. B Corp. does not assume the liabilities of D Corp. D Corp. dividends the proceeds paid by B Corp. to its shareholders. D Corp. then dissolves. What seemed corporeal has vanished as breath into the wind. Classically, the Cv were left without a deep pocket to sue.

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304 See 11 U.S.C. § 726(a)(6) (providing that after payment of all allowed claims, any surplus is returned to the debtor).

305 That is, the aggregate Cn claims constitutes a quantitative limit on T's avoidance powers. Carlson, Organizing Principle, supra note 51, at 563-73.

306 Urie v. Thompson, 337 U.S. 163, 176 (1949) (accrual when symptoms are manifest).

307 A future claim is "a claim against a debtor for an injury or disease that has not as yet become manifest at the time the debtor has filed for bankruptcy, but is based upon the occurrence, prior to the bankruptcy, of one or more material events, acts, or failure to act." Ralph R. Mabey & Jamie Andra Gavern, Constitutional Limitations on the Discharge of Future Claims in Bankruptcy, 44 S.C.L. REV. 745, 749-50 (1993).

308 See, e.g., Ramirez v. Amsted Indus., Inc., 431 A.2d 811, 823 (N.J. 1981) ("[a] cause of action does not accrue until the personal injury . . . occurs as a result of the defect.") (citations omitted).


310 Frederick Tung, Taking Future Claims Seriously: Future Claims and Successor Liability in Bankruptcy, 49 CASE W. REV. L. REV. 435, 445 (1999) ("The typical state corporation statute requires only that the dissolving corporation pay or provide for its known debts as a condition to dissolution. Unknown claims at the time of dissolution—in particular, future products liability claims—may be prejudiced by the dissolution.").

311 Turner v. Bituminous Cas. Co., 244 N.W.2d 873, 878 (Mich. 1976) ("To the injured person the problem of recovery is substantially the same, no matter what corporate process led to transfer of the first corporation and/or its assets Whether the corporate transaction was (1) a traditional merger . . . or (3) a purchase of corporate assets for cash, the injured person has the same problem, so long as the first corporation in each case legally and/or practically becomes defunct. He has no place to turn for relief except to the second corporation."); Tung, supra note 310, at 444-45.
The courts in at least fourteen states have addressed the plight of the C, by encumbering the factory with a "servitude." Whomever owns the factory inherits the liability to C,. Thus, successor liability awards the C, a property interest in the factory itself.

All sorts of restrictions are placed on this proposition. For example, only the future C, may sue B Corp.—the C, whose injuries occur after the B Corp. buys the factory. In addition, B Corp. must keep producing the product going forward. D Corp. must have ceased to exist after B Corp. buys the

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312Richard L. Cupp, Jr., Redesigning Successor Liability, 1999 U. ILL. L. REV. 845, 853-54, 857 (43% of the country's population live under successor liability).
313Servitudes are personal obligations that are imposed upon the owners of encumbered items simply by virtue of their being in possession of them. Servitudes are not mortgages or liens. The encumbered items are not necessarily collateral for debts of their owners. Rather, servitudes are strictly personal obligations that may be enforced as such against servitude-debtors only by the usual means of injunction or money judgments. The servient property merely signals whom the plaintiff may sue to enforce a contractual or tort duty.


If this is right, then, in the land use planning context, owners of the dominant tenement own no part of the servient tenement. But it is not so, as the following parable shows. Suppose D Corp. owns a factory and wishes to sell to X Corp. D Corp. and X Corp. agree that X Corp. shall have no liability to a C, who is injured by a defective product made by D Corp. C, is injured by D Corp.'s product after the sale of the factory to X Corp. X Corp. is nevertheless liable to the C,. Ramirez, 431 A.2d at 813, 817. The fact that D Corp. and X Corp. specifically agreed that X Corp. had no liability makes no difference. X Corp. is liable because X Corp. bought the factory. Whomever owns the factory has liability to the C,. C, 's claim follows the factory and proves that C, has a property interest in the factory itself. See Elliott v. General Motors, LLC (In re Motors Liquidation Co.), 829 F.3d 135, 155 (2d Cir. 2016) ("[S]uccessor liability claims can be 'interests' when they flow from a debtor's ownership of transfer red assets."); In re Chrysler LLC, 576 F.3d 108, 126 (2d Cir. 2010), vacated, 592 F.3d 370 (2d Cir. 2010)].
316The two slightly different manifestations of this requirement are "continuity of enterprise" and the product line approach. Swett, supra note 315, at 280; Richard L. Cupp, Jr., Redesigning Successor Liability, 1999 U. ILL. L. REV. 845, 848-49.
As a result of successor liability, B Corp. wisely discounts the price paid for the factory by the expected value of the Cv liabilities. Wealth is thus shifted from D Corp.’s undeserving shareholders to the deserving Cv. Taken to extremes, however, where Cv claims exceed the unencumbered value of the factory, the factory becomes unsellable.

Meanwhile, the creditors who are not post-sale victims (Cg \ Cv) have no rights against B Corp. Successor liability is strictly for the benefit of the Cv, not for the benefit of the Cg \ Cv. Therefore, the Cv are a proper subset of the Cg. Their rights are particularized creditor rights, not generalized creditor rights.

Suppose D Corp. is bankrupt. T wishes to sell its only asset (the factory) in a § 363(b) sale. D Corp., however, did not, prior to bankruptcy, own the fee simple of the factory. It owned a fee simple minus the right of the Cv to sue the successor. Without more, D Corp. can only sell the factory (to B Corp.) subject to the servitude in favor of the Cv. Knowing this, B Corp. will reduce the price paid by the present value of the Cv liabilities. Thus, the Cg \ Cv receive a pro rata share of the proceeds paid by B Corp. and the Cv later obtain 100 cents on the dollar from B Corp. Inability to foreclose the servitude implies that the Cv will obtain a preference over the Cg \ Cv (where B Corp. is solvent).

Courts have struggled with the issue whether T can sell the factory free and clear of the tort servitude on the factory. This requires the courts to find some part of § 363(f) that covers the servitude. The task is formidable.
because the very point of successor liability is to block a free and clear sale under state law. Curiously, courts that find successor liability foreclose-able think they are done by showing that successor liability rights are an “interest” in collateral. Thus, per Bankruptcy Code § 1141(c), confirma-
tion of a plan implies that “the property dealt with by the plan is free and clear of all claims and interests of creditors . . . “

It seems to us, however, that it must also be shown that the successor liability servitude is described in one of the five subparagraphs to § 363(f). According to § 363(f):

The trustee may sell property . . . free and clear of any interest in such property of an entity other that the estate [i.e., the C], only if

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
(2) such entity consents;
(3) such interest is a lien . . .
(4) such interest is in bona fide dispute; or
(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

We assert the primacy of § 363(f)(3) over § 1141(c).

The more learned among our readers might protest that the C have no cram down rights under Bankruptcy Code § 1129(b). That provision basically says that, when the relevant class of creditors votes against confirmation of a reorganization plan, secured creditors are entitled to a continuation of their liens. The C don’t have any liens. Therefore, the C may be

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328 According to a Seventh Circuit panel:
What the imposition of successor liability would accomplish, and what the district court objected to, would be a second opportunity for a creditor to recover on liabili-
ties after coming away from the bankruptcy proceeding emptyhanded. But a second change is precisely the point of successor liability, and it is not clear why an inter-
vening bankruptcy proceeding, in particular, should have a per se preclusive effect on the creditor’s chances.

Chicago Truck Drivers, Helpers & Warehouse Workers Union (Independent) Pension Fund v. Tasemkin, Inc, 59 F.3d 48, 51 (7th Cir. 1995).

329 Elliott v. General Motors, LLC (In re Motors Liquidation Co.), 829 F.3d 135, 155 (2d Cir. 2016). There seems to be an idea afoot that the C have a claim against B Corp. and that § 363(f) cannot eliminate this claim because § 363(f) only eliminates interests. But the C have a claim against B Corp. because they have an interest in the factory. The Motors court ruled that § 363(f) eliminates claims. Id. at 155-56. It need not have bothered. If the servitude falls under § 363(f), the C claims fall as well.

330 11 U.S.C. § 1141(c) (emphasis added).
332 Id. § 1129(b)(2)(A)(i)(I).
crammed down whenever no junior creditor or holder of a junior "interest" receives a distribution under the plan. And therefore it further follows that a plan may be confirmed over the opposition of the C, when the factory is sold free and clear of their servitude interest.

But this overlooks the fact that T can only sell D Corp. property. It cannot sell the property of third parties, unless § 363(f) authorizes a free and clear sale. The C, are third parties, and they own a piece of the factory. Therefore, T must show that the sale of the factory free and clear of the servitude is authorized by § 363(f)(3). If the trustee cannot show this, the C, can block confirmation of the plan, just as any third party could, where the plan proposes the looting of third party property.

At least some courts have found ways to proclaim a free and clear sale. As a result, B Corp. pays the fee simple value of the factory. The bankruptcy estate is enhanced, raising the issue whether the enhancement belongs to the C, alone or whether it belongs to the Cg as a group. The answer seems to be favor the Cg. Free and clear sales, of course, give rise to proceeds. Proceeds go to third parties only if D Corp. and "an entity [has] entered into a security agreement before the commencement of the case." So, even though the C, lose a property right if the factory is sold free and clear, they have no right to the proceeds. They are merely unsecured creditors in D Corp.'s bankruptcy, who share pro rata in the enhanced purchase price.

It is clear (at least to us) that bankruptcy sales do not per se eliminate the

333 Id. § 363(b).
334 That chapter 11 plans cannot expropriate third-party property is a major theme in Schroeder & Carlson, supra note 6.
335 See Reed, supra note 320, at 664-66 (collecting cases going both ways) see also Michael H. Reed, Successor Liability and Bankruptcy Sales Revisited—A New Paradigm, 61 BUS. LAW. 179, 192 (2005) ("[C]ourts which found that section 363(f) authorizes sales free and clear of successor liability claims relied primarily on policy grounds rather than statutory construction."). In asbestos cases, foreclosure of successor liability is directly authorized. 11 U.S.C. § 524(g)(3)(A)(ii).
336 There is a connection, however, between a free-and-clear sale, notice to the C, and participation of the C, in the chapter 11 case. Elliott v. General Motors, LLC (In re Motors Liquidation Co.), 829 F.3d 135, 166 (2d Cir. 2016); Volvo White Truck Corp. v. Chambersburg Bev., Inc. (In re White Motor Credit Corp.), 75 B.R. 944 (Bankr. N.D. Ohio 1987).
339 Douglas v. Stamco, 363 F. App’x 100, 102 (2d Cir. 2010) (“Allowing the plaintiff to proceed with his tort claim directly against [B Corp.] would be inconsistent with the Bankruptcy Code’s principle scheme because a plaintiff’s claim is otherwise a low-priority, unsecured claim”). Such a conclusion runs counter to Bankruptcy Code § 363(e):

[A]t any time, at the request of an entity that has an interest in property used... by the trustee, the court, without or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection.

11 U.S.C. § 363(e). Notice that § 363(e) does not just apply to lien creditors. Property owners (such as the C,) are entitled to have their interests adequately protected. On the application of § 363(e) to succes-
servitude. A court must expressly declare that the servitude is dead after the sale, and then only if the C receive notice and a hearing.\textsuperscript{340}

If the factory is sold free and clear of the C servitude, wealth is transferred back from the C to the C.\textsuperscript{341} The Bankruptcy Code has a very expansive definition of "creditor."\textsuperscript{342} The definition involves future creditors, and so the C who have no law suit against B Corp. under state law, have a right to a pro rata share of the bankruptcy estate. There seems to be a connection between C's loss of the servitude and C participation in the bankruptcy distribution.\textsuperscript{343}

Enough has been said to show that foreclosure of successor liability in bankruptcy is an exceptionally subtle issue. It requires a deep reading of § 363(f)(3). It is disappointing, then, to encounter Emoral, Inc. v. Diacetel (In re Emoral, Inc.).\textsuperscript{344} In Emoral, D Corp. sold a factory to B Corp. Under New Jersey law, B Corp. has successor liability to the C.\textsuperscript{345} Properly, the C has particularized creditor rights. The C could sue B Corp. but the C could not.

D Corp. then filed for bankruptcy. T claimed B Corp. paid too little for the factory; the transfer was said to be a fraudulent transfer. Now given the fact that B Corp. bought the factory subject to the servitude should have figured in the calculation of whether B Corp. paid too little. There is no indication the parties considered this matter.

In any case, B Corp. and T entered into a settlement. B Corp. paid a sum of money to T and B Corp. was released from "any cause of action that [is] property of the Debtor's estate."\textsuperscript{346} A further sentence was added to the settlement agreement: "Nothing contained in [the settlement] will operate as a release of . . . any claims held by any person which do not constitute Estate's released Claims as defined in the [settlement agreement]."\textsuperscript{347} This

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\textsuperscript{340}In Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.). 43 F.3d 714, 720 (1st Cir. 1994).

\textsuperscript{341}Brubaker, supra note 279, at 989 ("Creditors without valuable non-debtor rights can take value away from creditors whose valuable non-debtor rights are extinguished through non-debtor releases").

\textsuperscript{342}Lawrence Ponoroff, Neither Twixt Nor ‘Tween: Emerging Property Interests in Bankruptcy, 61 Ariz. L Rev. 101, 108 (2019) ("A claim may, and often does, arise for bankruptcy purposes well before a cause of action based on the same facts accrues under state law").

\textsuperscript{343}In re Grumman Olson Indus., Inc., 467 B.R. 694, 711 (S.D.N.Y. 2012); In re Old Carco LLC, 492 B.R. 392, 403 (S.D.N.Y. 2013). In Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.). 43 F.3d 714, 720 (1st Cir. 1994), the court begged the question of whether successor liability could be foreclosed by § 363(f) because the C had never received due process with regard to the sale.

\textsuperscript{344}740 F.3d 875 (3d Cir. 2014).


\textsuperscript{346}Emoral, 740 F.3d at 877.

\textsuperscript{347}Id.
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proviso would seem to describe the $C_v$ precisely.

The $C_v$ brought suit against $B$ Corp. in New Jersey. $B$ Corp. returned to the bankruptcy court seeking an order upholding the settlement, on the theory that $T$ owned the $C_v$ claims because the $C_v$ claims were generalized creditor rights. The bankruptcy court disagreed, rightly finding that the $C_v$ were a proper subset of the $C_g$ and therefore had particularized creditor rights.

On appeal, the bankruptcy court was reversed. Said the district court:

\[ T \text{the potential liability of } [B \text{ Corp.}] \text{ to the } [C_v] \text{ does not arise out of the alleged misfeasance of } [B \text{ Corp.}] \text{ as to these creditors individually but rather out of its alleged continuation of the general business operation of the actual alleged wrongdoer. Put slightly differently, for purposes of determining whether the cause of action belongs to the Estate, the critical distinction between the personal injury claim against } [D \text{ Corp.}] \text{ and the successor liability claim against } [B \text{ Corp.}] \text{ is that establishing the former would benefit only the allegedly injured } [C_v] \text{ whereas establishing the latter—that } [B \text{ Corp.}] \text{ is the “mere continuation” of } [D \text{ Corp.}] \text{ and thus should be charged with all its liabilities—would benefit } [the C_g] \text{ generally.}^{348} \]

The court of appeals was in accord with this view. It ruled that the $C_v$ “fail[ed] to demonstrate how any of the factual allegations that would establish their cause of action based on successor liability are unique to them as compared to [the $C_g$].”\(^ {349} \)

But this misunderstands the servitude and confounds successor liability with piercing the veil in general. $T$ was clearly not piercing the veil. $T$ was pursuing a fraudulent transfer, which presupposes the distinction between $D$ Corp. and $B$ Corp. $D$ Corp. cannot transfer to $B$ Corp. if $D$ Corp. is $B$ Corp.\(^ {350} \) When $T$ settles a fraudulent transfer suit, $T$ stipulates that $D$

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\(^ {348} \)Id. at 878 (quoting district court opinion).
\(^ {349} \)Id. at 880.
\(^ {350} \)According to one criticism:

The two judges in the majority did so based on their view that as a legal matter, the claim for successor liability was for the benefit of all of the estate's creditors. But they did not, so far as this Court can discern, parse the plaintiff's complaint to focus on what the plaintiffs were actually asking for, to see if that was actually true. [The dissent] found the majority's mechanical approach troublesome for several reasons, most significantly because the majority failed to consider, as a factual matter, what he considered to be critical—whether [the $C_v$] would be suing for themselves or for the benefit of all.

\( In \text{ re Motors Liquidation Co., 529 B.R. 510, 552-53 (S.D.N.Y. 2015), rev'd, 829 F.3d 135 (2d Cir. 2016). } \)
Corp. and B Corp. are separate persons. The C, may not thereafter pursue a piercing theory. But that was not what the C, were doing in Emoral. The C, were asserting their servitude right against B Corp. The C, owned the benefit of that servitude and B Corp. was burdened reciprocally by the servitude.

Whether B Corp. bought free and clear of the servitude is a complex question. But to decide the case on the basis that the C, had a "generalized creditor right" was palpably inadequate. The generalized v. particularized distinction is simply not up to the task.

Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.) was not a successor liability case. Rather, it concerned whether a fraudulent transfer settlement precluded C, subsequent tort action against X Corp. on a veil piercing theory. The answer was in favor of preclusion. The Tronox court took Emoral to be a simple veil piercing case (not a successor liability case). It therefore commented at length on Emoral, siding with the majority against the Emoral minority.

According to the Tronox reading of Emoral, C, was attempting to recover assets that B Corp. had looted from D Corp. But this was not so. In Tronox, B Corp. had bought a factory from D Corp. for cash—albeit enhanced when T sued B Corp. for paying too little and B Corp. settled. C, would have courts allow an individual creditor to sue third-party successors of [D Corp.] for claims that are truly aimed at recovering estate assets. The exact claim advanced by [T] on behalf of the estate would be a win for all creditors of the estate but a win by a single creditor would be a win by one to the detriment of the others.

In fact, the C, in Emoral were not seeking D Corp. assets or assets of the bankruptcy estate. The C, were not even seeking just the factory. Pursuant to the benefit of their servitude, the C, were seeking a judgment against B Corp. which in turn would entitle the C, to lien upon any asset of B Corp. (including the factory).

Thus the Second Circuit viewed as natural that the C, in Emoral had the right to a wealth transfer from the C, to themselves. Therefore, settlement of the fraudulent transfer claim against B Corp. was also a § 363(f) foreclosure of the factory servitude. Such a view, however, is in violation of Caplin. The

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351 In dissent, Judge Robert E. Cowen relied on the generalized/particularized dichotomy, finding that not just any C, could sue B Corp. Only the C, could. Since the C, were a proper subset of the C, the trustee was not subrogated to the C, claims. This was straightforwardly correct. 740 F.3d at 885-86.
352 See Swett, supra note 315, at 309.
353 855 F.3d 84 (2d Cir. 2017).
354 See supra text accompanying notes 269-83.
355 Tronox, 855 F.3d at 104.
356 See supra text accompanying notes 17-19.
were a proper subset, and \( T \) did not own the \( C_v \) claims against \( B \) Corp.\textsuperscript{357}

In the context of successor liability, the \( C_v \) may attempt to plead inconsistent causes of action against \( X \) Corp. In \textit{Keene Corp. v. Coleman (In re Keene Corp.)},\textsuperscript{358} \( D \) Corp.'s parent corporation incorporated \( X \) Corp., transferred factories to \( X \) Corp., and then "spun" \( X \) Corp. off—that is, offered shares in \( X \) Corp. to the investing public. \( D \) Corp. was soon insolvent. The \( C_v \) (who had asbestos claims connected with the factory) threw the book at \( X \) Corp. The \( C_v \) charged \( X \) Corp. with veil piercing, fraudulent transfer and successor liability. Soon thereafter \( D \) Corp. was bankrupt. But these are contradictory theories. Both fraudulent transfer and successor liability requires a transferor (\( D \) Corp.) and a transferee (\( X \) Corp.). If \( X \) Corp. is \( D \) Corp.—if the veils ought to be pierced—then the fraudulent transfer and successor liability counts must fail.

\( D \) Corp. (as debtor-in-possession) sought a court order from the bankruptcy court enjoining continuation of the \( C_v-X \) Corp. law suits. Properly, so long as the piercing claim was valid, \( D \) Corp. was entitled to the court order. \( X \) Corp.'s assets were \( D \) Corp.'s assets, and any suits against \( X \) Corp. were attempts to control \( D \) Corp. assets. Also, the \( C_v \) could not pursue fraudulent transfer theories. \( D \) Corp. (as debtor-in-possession) was subrogated to those rights; the factories were thus property of the bankruptcy estate.

But the successor liability stood on a different basis. the \( C_v?C_g \) were a proper subset, and so \textit{Caplin} applies to deny \( D \) Corp. (as bankruptcy trustee) the standing to bring these claims.

The \textit{Keene} court equated successor liability with veil piercing:

\[ \text{[T]he remedy against a successor corporation for the tort liability of the predecessor is, like the piercing remedy, an equitable means of expanding the assets available to satisfy creditor claims. Their standing depends on their status as creditors of \[ D \text{ Corp.}], and their success would have the effect of increasing the assets available for distribution to all creditors.} \textsuperscript{359} \]

This passage has some mysterious aspects. The court indicates that the standing of the \( C_v \) depends upon the \( C_v \) being creditors of \( D \) Corp. and that therefore the \( C_v \) are trespassing on the prerogative of \( T \). This would appear to be a non sequitur. Suppose in a different case \( C \) lent to \( D \) and \( S \) guaranteed the


\textsuperscript{358} Id. at 844 (Bankr. S.D.N.Y. 1994).

\textsuperscript{359} Id at 853.
loan. After default, D files for bankruptcy. C sues S. No one would say that
the automatic stay prevents C from suing S.360 No one would say that T
owns C's right against S because C's right against S depends on C being a
creditor of D. Yet that is what the court's reasoning implies.

Also very questionable is the proposition that if TDC were successful,
bankruptcy assets available for distribution would increase. This is no argu-
ment at all! It is tantamount to observing that if T could legally rob banks,
the creditors of D Corp. would benefit. Therefore, T may rob a bank by
means of a chapter 11 plan. The argument begs the question whether the
Bankruptcy Code sanctions these expropriations. Common sense and Cap-
lin361 say no.362

Nevertheless, the Cv veil piercing theory is a great fish that swallows
whole the Jonah-like successor liability theory. Under veil piercing, all X
Corp. assets are D Corp. assets. The Cv suit for successor liability is an at-
ttempt to get X Corp.-D Corp. assets and is properly covered by the auto-
matic stay.363 If T abandons veil piercing, however, this cause of action,
together with the successor liability theory, would revert back to the Cv. If
X Corp. assets are considered not administered within the meaning of
§ 554(d), T can reopen the case and make the Cv account for estate assets.
But if the Cv do not use a piercing theory and rely only on successor liability,
the avails of the successor liability belong to the Cv and would never be
property of the estate.

VI. INSURANCE PROCEEDS

In mass tort bankruptcies, a major asset of D Corp. is a products-liability
insurance policy (IP),364 which is capped at some large number of dollars.365
The IP is defined by Cv, claims against D Corp. subject to the cap. In effect,
the IP is D Corp.'s "insurance receivable."366 But it is an odd sort of receiv-
able. The size of the receivable is measured by the size of the Cv claims (sub-
ject to the cap).

2021).
362See Fisher v. Aposolou, 155 F.3d 876, 880 (7th Cir. 1998) ("T "obviously may not roam around
collecting whatever property suits her fancy. Her task is to recover and manage the 'property of the estate'
...").
(2d Cir. 2016) (agreeing with the Kerne result on this basis).
364See e.g., Johns-Manville Corp. v Chubb Indem. Ins. Co. (In re Johns-Manville Corp.), 600 F.3d 135,
152 (2d Cir. 2010) (per curiam) ("[T]he insurance policies that Travelers issued to [D Corp.] are the
estate's most valuable asset.") but see Cissell v. American Home Assurance Co., 521 F.2d 790 (6th Cir.
1975) (D Corp. had no interest in the IP; the Cv alone owed this fund).
By legislation, the $C_v$ have a “direct action” right against the IP. In the direct action, a $C_v$ proves the tort and the insurance company (IC) pays, reducing $D$ Corp.’s policy limit. Such legislation effectively makes the $C_v$ secured creditors of $D$ Corp., with the IP serving as collateral. Under state law, the $C_v$ priority is “first in time is first in right.”

The IP is therefore always fully encumbered. The $C_v$ have a security interest in it, but there can never be a debtor surplus, as might be the case with standard Article 9 security interests on receivables. This follows from the fact that the size of the receivable is measured by the quantity of $C_v$ claims against it.

When $D$ Corp. files for bankruptcy, the insurance receivable is property of the bankruptcy estate, as encumbered by the secured claims of the $C_v$. Typically, IC “settles” with T. IC pays the policy limit and T agrees to a “channeling” injunction, forbidding any $C_v$ from suing the IP directly. The automatic stay achieves this result only provisionally. While the bankruptcy proceeding is ongoing, the $C_v$ are prohibited from pursuing the IP. The channeling injunction, however, is forever. It does not end when $D$ Corp.’s bankruptcy proceeding terminates.

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367David Gray Carlson, Indemnity, Liability, Insolvency, 25 CARDOZO L. REV. 1951 (2004); cf. Barry L. Zaretsky, Insurance Proceeds in Bankruptcy, 55 BROOKLYN L. REV. 373 (1989) (“Under either the indemnification or the direct action approach, at some point the insurer becomes, in effect, a co-debtor with the insured on the obligation”). Because Professor Zaretsky tentatively viewed the insurance company as a co-debtor (rather than as an account debtor), he opined incorrectly that direct actions could be brought against the insurer without violating the automatic stay. Id. at 383; see In re Davis, 730 F2d 176 (5th Cir. 1984) (per curiam) (a bankruptcy court could enjoin the $C_v$ from suing insurer directly). But ultimately Zaretsky concluded that the IP was property of the bankruptcy estate, thus triggering the stay. Zaretsky, supra, at 384, 392 n.56 (wondering whether the $C_v$ are secured creditors).

368Carlson, Indemnity, supra note 367, at 1957-60.

369See MacArthur Co v. Johns-Manville Corp., 837 F.2d 89, 93 (2d Cir. 1988); Minoco Groups of Cos., Ltd. v. First State Underwriters Agency of New England, 799 F.2d 517 (9th Cir. 1986) (automatic stay prevents cancellation of IP since IP was property of the estate); see Travelers Indem. Co. v. Bailey, 557 U.S. 137, 161 (2009) (“[t]he court has in rem jurisdiction over the Policies and thus the power to enter appropriate orders to protect that jurisdiction . . .”).

370MacArthur Co., 837 F.2d at 93; Zaretsky, supra note 367, at 405-14. According to the Supreme Court:

This is but an application of the well recognized rule that when a court of competent jurisdiction takes possession of property through its officers, this withdraws the property from the jurisdiction of all other courts which, though of concurrent jurisdiction, may not disturb that possession; and that the court originally acquiring jurisdiction is competent to hear and determine all questions respecting title, possession and control of that property.

Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734, 737-38 (1931); see also Quigley Co. v. Law Offices of Peter G. Angelos (In re Quigley Co.), 676 F3d 45, 52 (2d Cir. 2011). On channeling injunctions, see Brubaker, supra note 279, at 1026-48. For a description of the Manville bankruptcy where these concepts were first developed, see Georgene Vairo, Mass Tort Bankruptcies: The Who, the Why and the How, 78 AM. BANKR. L.J. 93, 100-106 (2004).
In 1994, Bankruptcy Code § 524(g) ratified the channeling injunction. But § 524(g) governs only in asbestos cases. In such cases, the injunction requires confirmation of a chapter 11 plan where the C, have a cram-down-proof right to veto the plan if 25 percent of them vote thumbs down.

Since the C, are secured creditors, their distributions are governed by Bankruptcy Code § 725:

After the commencement of a case under this chapter, but before final distribution of property of the estate under section 726 of this title, the trustee, after notice and a hearing, shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.

The assumption is that the C, share the insurance proceeds on a pro rata basis between themselves, but no principle of state law commands this. Bankruptcy courts impose equality with a wink and a nod.

In cases involving insurance settlements, the Second Circuit has used “general/derivative v. particular/not derivative” to adjudicate whether a C, is subject to the channeling injunction (general) or not (particular). More recently, this test has been rejected. In MacArthur Co v. Johns-Manville Corp., C, (a vendor of D Corp. products) sought a declaration from the bankruptcy court that its claim against an IP was not covered by the channeling injunction. The court held C,'s claim was “derivative,” and so the injunction applied. What the court really meant was that C, was seeking property of the bankruptcy estate (the IP) in violation of the injunction, which extended the effect of the automatic stay.

In Johns-Manville Corp. v. Chubb Indemnity Ins. Co. (In re Johns-Manville Corp.), however, C, sued the insurer in spite of the channeling

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372Section 524(g)(1)(B) authorizes the injunction for litigation trusts described in § 524(2)(B)(i). And § 524(g)(2)(B)(i)(I) requires that the injunction be for the benefit of a trust that assumes liabilities for damages cause “by the presence of . . . asbestos-containing products.”
375837 F.2d 89 (2nd Cir. 1988).
376C,’s “rights as an insured vendor are completely derivative of [D Corp.’s] rights as the primary insured . . . Such derivative rights are no different . . . from those of the [C,] who have already been barred from asserting direct action against the insurer.” Id. at 92.
377In its interpretation of MacArthur, the Second Circuit remarks, “The fact that [C,]’s rights under the vendor endorsements were derivative of [D Corp.’s] . . . indicated in that case that any proceeds [D Corp.’s] insurers might owe [C,] would come from [D Corp.’s] insurance policies.” Quigley Co. v. Law Offices of Peter G. Angelos (In re Quigley Co.), 676 F.3d 45, 55 (2nd Cir. 2011).
injunction.\textsuperscript{579} C\textsubscript{1} alleged that the insurer breached a duty to C\textsubscript{1} by failing to disclose health information.\textsuperscript{380} Inspired by \textit{MacArthur}, the insurer returned to the bankruptcy court to enjoin C\textsubscript{1} from suing. The bankruptcy court ruled that the insurer was being charged with "acts or omissions by [the insurer] arising from or relating to ... insurance relationships with [D Corp.]."\textsuperscript{381} The alleged acts arose out of and were "related to" the IP.\textsuperscript{382}

The court of appeals reversed. It saw the issue as "primarily a question of jurisdiction."\textsuperscript{383} It ruled that where C\textsubscript{1}'s claim was "non-derivative," i.e., particularized, a bankruptcy court did not even have jurisdiction to enjoin C\textsubscript{1} from suing the insurer. C\textsubscript{1}'s action was not derivative of its claim against \textit{D Corp.} It was based on the acts of the insurer and did not impact upon the IP limit. Key to the reasoning was the fact that C\textsubscript{1}'s recovery (if any) would not be charged against the IP issued by the insurer.\textsuperscript{384} In this case, "non-derivative" meant no impact on the insurance receivable.\textsuperscript{385}

In \textit{Quigley Co. v. Law Offices of Peter G. Angelos (In re Quigley Co.)},\textsuperscript{386}

\textsuperscript{579}The Confirmation Order simultaneously enjoins 'all persons' from commencing any action against any of the Settling Insurance Companies 'for the purpose of, directly or indirectly, collecting, recovering or receiving payment of, on or with respect to any Claim ... or Other Asbestos Obligation.' \textit{Johns-Manville}, 517 F.3d at 57.

\textsuperscript{580}Id. at 58 ("Many of these theories of liability have not been accepted by any court.").

\textsuperscript{581}Id. at 60.

\textsuperscript{582}Id.

\textsuperscript{583}Id.

\textsuperscript{584}Id. at 65. ("Here ... [the C\textsubscript{1}] seek to recover directly from a debtor's insurer for the insurer's own independent wrongdoing ... They raise no claim against \textit{D Corp.'s} insurance coverage"); see also Johns-Manville Corp. v Chubb Indem. Ins. Co. (In re Johns-Manville Corp.), 600 F.3d 135, 145-46 (2d Cir. 2010) (per curiam).

\textsuperscript{585}The Supreme Court reversed, basically, on other grounds. Travelers Indemnity Co. v. Bailey, 557 U.S. 137 (2009). It ruled that C\textsubscript{1} was clearly covered by the channelling injunction and that, right or wrong, res judicata prevented revisiting whether a channelling injunction can constitutionally bar suits against insurers for insurer wrongdoing. \textit{Id.} at 152; see also \textit{id.} at 155 ("[O]ur holding is narrow. We do not resolve whether a bankruptcy court in 1986 or today, could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's wrongdoing."). The Second Circuit opinion therefore has validity as a comment on what a channelling injunction is capable of doing. In fact, a C\textsubscript{1} (that received no due process in the original Manville proceeding) was held to be outside the channelling injunction because its claim against the insurer was nonderivative. \textit{Johns-Manville Corp. v Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)}, 600 F.3d 135, 1552 (2d Cir. 2010) (per curiam).

In \textit{Continental Cas. Co. v. Carr (In re W.R. Grace & Co.)}, 13 F.4th 279 (3d Cir. 2021), the court, in a case with facts identical to \textit{Chubb}, ruled that the channelling injunction potentially protected IC because IC would not have undertaken to publicize health information if \textit{D Corp.} had not hired IC to do so. Therefore, IC could hide behind the channelling injunction even though its liability for breach of this duty was its own and would not reduce \textit{D Corp.'s} insurance receivable. For C\textsubscript{1} to prevail, C\textsubscript{1} had to show that IC's misconduct was "wholly independent" of \textit{D Corp.'s} defective product. The court, however, stopped short of ruling that the channeling injunction protected IC. This would depend on whether Montana law viewed the health disclosures as part and parcel of the service of insuring \textit{D Corp.} from product liability. The case was remanded for the bankruptcy court to determine what "providing insurance" means in Montana.

\textsuperscript{586}676 F.3d 45 (2d Cir. 2011).
the court denied that derivative v. nonderivative was really the test. The Quigley court faced a conundrum. Bankrupt D Corp. and its parent, P Corp., shared the IP on a first come, first served basis.387 Thus, any loss sustained by P Corp. and reimbursed from the IP would reduce D Corp.'s insurance receivable, a violation of the automatic stay. A channelling injunction also existed. Under the protection of the channelling injunction, D Corp.'s bankruptcy estate could "steal" the receivable for D Corp.'s C_v because the C_v of P Corp. were barred from access. Loss of the IP meant that P Corp. would have to pay. The arrangement smacks of larceny by D Corp.'s bankruptcy estate at the expense of P Corp.388

D Corp. manufactured an asbestos product, but P Corp. permitted D Corp. to use P Corp.'s logo on the product. According to Restatement (2d) Torts § 400, "one who puts out as his own product a chattel manufactured by another is subject to the same liability as though he were its manufacturer."389 The logo principle has been endorsed in Pennsylvania.390 So C_v had a Pennsylvania claim against solvent P Corp. for products liability, as well as a claim against D Corp.

C_v, naturally, brought suit against solvent P Corp. in Pennsylvania. P Corp. returned to bankruptcy court for an order restraining C_v from bringing this suit. The bankruptcy court found that C_v's suit was barred by the channelling injunction, but the higher courts disagreed.391

According to the Second Circuit, the channelling injunction could have barred C_v's claim against P Corp.392 C_v's claim would lead to P Corp.'s claim against the IP, which drains an asset of D Corp.'s bankruptcy estate. Thus, Quigley denied the relevancy of the derivativity test. In Chubb, non-derivativity freed C_v to sue the insurer. But in Quigley, non-derivativity did not

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387 Id. at 47 (D Corp. and P Corp. "have used and may continue to use the policies and the trust 'to satisfy settlements, judgments and defense costs' ... The Insurance Policies and Insurance Trust cover claims against [P Corp.] or [D Corp.] on a first billed, first paid basis, irrespective of amounts previously billed by or paid to [P Corp.] or [D Corp.]. Quigley contemplates that 'the remaining limits under the Shared Insurance Policies and the amounts contained in the Insurance Trust ... will be used to fund [its] pre-negotiated plan or reorganization.') (citing In re Quigley Co., Inc., 449 B.R. 196, 198 (S.D.N.Y. 2011)).

388 P Corp. in Quigley was in the same position as C_v in MacArthur. Both were separate corporate entities who had access to the IP. Both would have to go hat in hand to the bankruptcy court for a pro rata share of the IP. Quigley, 676 F.3d at 53.


391 Appellate jurisdiction was a concern. The bankruptcy court had merely confirmed that the channelling injunction covered C_v. This was not a new order or a new modification of the old order. The court reasoned that the bankruptcy court's action was "the equivalent of a decision from that court on a motion seeking relief from a stay." Quigley, 676 F.3d at 51. Since denial of a motion to lift the stay is appealable, so was the bankruptcy court's clarifying order.

392 Id. at 58 ("Accordingly, we conclude that, where [C_v v. P Corp.] would almost certainly result in the drawing down of insurance policies that are part of the bankruptcy estate of [D Corp.], the exercise of bankruptcy jurisdiction to enjoin these suits was appropriate").
necessarily free C₁ to sue a co-insured. The test has been left in tatters.³⁹³

In the end, the court ruled that the channelling injunction issued in Quigley (which “parroted”)³⁹⁴ the provisions of Bankruptcy Code § 524(g)(4)(A)(ii),³⁹⁵ did not actually apply to logo claims. C₁ was therefore free to sue P Corp., which would have the effect of lowering D Corp.’s insurance receivable.

According to § 524(g)(4)(A)(ii), an injunction may shield a third person “to the extent such alleged liability of such third party arises by reason of—(I) the third party’s ownership of a financial interest in the debtor...”³⁹⁶ The bankruptcy court in Quigley had read its own order as barring C₁, on this ground. P Corp. owned D Corp., and that was the reason P Corp. lent its logo to the D Corp. product. Therefore, C₁’s claim arose by reason of P Corp.’s interest in D Corp.

The Second Circuit disagreed. “By reason of” does not mean “but for.” “But for” the fact that P Corp. owned D Corp., P Corp. probably never would have lent its logo to D Corp.’s baleful products. “By reason of” in § 524(g)(4)(A)(iii) means “as a legal consequence of.” Thus, P Corp.’s ownership of D Corp. did not mean that, legally, D Corp. could use the logo over P Corp.’s opposition. As a counter-example, the Second Circuit offered piercing the veil. If the veil could be pierced, the logo belonged to D Corp. because D Corp. and P Corp. would have been the same person. But piercing was not appropriate in Quigley. D Corp.’s use of the logo did not stem from P Corp.’s ownership of D Corp. shares. So the channeling injunction, which parroted § 524(g)(4)(A)(iii), did not protect P Corp. from the C₁, who were free to sue P Corp.

CONCLUSION

Creditors of a debtor and a debtor’s bankruptcy trustee often vie for the right to recover from third parties. If the trustee prevails, the bankruptcy

³⁹³But whether the direct result of a suit against a third party will be the removal of assets from the bankruptcy estate is separate from the question whether the third party’s allegedly liability is derivative of the debtor’s (although in certain suits, as our case law indicates, the two questions may be intertwined).” Id. at 58. Quigley overrules Chubb to the extent Chubb suggested a channelling injunction is available only in “situations where a third party has derivative liability for the claims against the debtor. John-Manville, 517 F.3d at 67-68.

³⁹⁴Quigley, 676 F.3d at 59 (a regulation that “parrots” a statute is not entitled to Chevron deference).

³⁹⁵Because the channelling injunction parroted § 524(g)(4)(A)(ii)), the Second Circuit gave no deference to the bankruptcy court’s interpretation of its own order. The Second Circuit treated the issue as one that interpreted the meaning of the statute. Id. at 58. Section 524(g), however, did not technically apply, since that provision requires the injunction to be in a confirmed chapter 11 plan. Section 524(g) merely “inspired: the bankruptcy court to sculpt a channelling injunction based on the automatic stay provision. Id. at 58 n.16.

estate is enhanced for the benefit of all the creditors. If an individual creditor prevails, the creditor keeps the avails to herself and does not have to share.

Courts have tried to develop a unified “string” theory to adjudicate the many types of standing disputes that exist between a bankruptcy trustee and self-seeking individual creditors. According to this unified theory, a generalized creditor right belongs to the bankruptcy trustee and never to an individual creditor. A particularized creditor right always belongs to the individual creditor and never to the trustee. This test is often stated in different words: if a creditor’s right is “derivative” of the debtor’s right, the trustee has standing and individual creditors have none. If a creditor’s right is nonderivative—particularized—the trustee never has standing.

This unified theory is a failure. It announces a result but never determines it. On occasion, it leads to incorrect results. The quest for a unified test should be abandoned. Instead, the issues covered here are solved by the following propositions:

1. Does an individual creditor have any right at all against a third party or her property? If so, the creditor has that right, even though the debtor is in bankruptcy, unless some specific provision in the Bankruptcy Code—basically, 544(b)(1)—provides otherwise.

2. If debtor has a right against a third party and a creditor has no right against that third party, except the right to the right to levy debtor property following money judgment, then the trustee inherits that right from the debtor under Bankruptcy Code § 541(a)(1). Creditors are in violation of the automatic stay if they try to garnish property of the bankruptcy estate.

3. If the debtor and the third party are one and the same person, then the third person’s property is debtor property, and the trustee inherits third party property under Bankruptcy Code § 541(a). Any attempt by a creditor to reach third party property is an attempt to reach debtor property and is in contravention of the automatic stay.

These are the real issues in allocating standing between a bankruptcy trustee and the individual creditors. The generalized/particularized dichotomy does no work in this allocation.