An Approach to Intellectual Property, Bankruptcy, and Corporate Control

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AN APPROACH TO INTELLECTUAL PROPERTY, BANKRUPTCY, AND CORPORATE CONTROL

F. SCOTT KIEFF & TROY A. PAREDES

ABSTRACT

Corporate control is the central concern of corporate law, and, in addition to priority, has become a core concern of bankruptcy. The question of corporate control in bankruptcy is especially important for intellectual property ("IP") rights. Bankruptcy proceedings do not compromise fundamentally the value of most tangible assets. Tangible assets generally retain their value both during and after bankruptcy proceedings, although there is always the risk that the business will be run poorly. IP is different. IP rights are typically most valuable when they carry a credible threat of injunction. As a result, to the extent the delay and coordination problems of bankruptcy lead to the under-enforcement of a debtor’s IP rights—or simply to the impression of under-enforcement—bankruptcy can frustrate the important coordination benefits IP rights otherwise serve. The bankruptcy process itself potentially can erode the private value of IP to a firm and all of its constituencies, as well as the public value of IP in facilitating downstream commercialization of the subject matter IP otherwise protects. To ensure that a debtor’s IP rights are enforced vigorously in bankruptcy, a party with the right incentives, information, and resources, as well as with standing to sue, must have control over IP assets in bankruptcy.

A prepackaged bankruptcy or an assignment of a debtor’s IP assets for the benefit of its creditors might mitigate the delay and coordination problems of bankruptcy. Borrowing from structured finance, we explore a different option: the creation of a bankruptcy-remote special purpose...
entity ("SPE") to which a company transfers all or part of its IP assets to ensure that the assets do not become part of the company’s bankruptcy estate when and if the company is ever in bankruptcy. A properly structured “IP SPE” would have the critical attribute that a holder of IP must have to ensure the value of the IP: the credible perception by all market players that the SPE can enjoin infringers of, as well as transact over, the IP. The sort of “IP securitization” that we outline is very similar in structure to a traditional asset securitization.

One of the principal normative criticisms of the IP securitization structure, as we propose it, is that the structure might accelerate what some might see as the death of legal liability by removing assets from the reach of a debtor’s creditors in bankruptcy. Accordingly, in addition to outlining the IP securitization structure, this Essay briefly explores how the death of legal liability may be exaggerated and how concerns over the death of legal liability may be overstated. More to the point, in some instances, IP securitization may best ensure the value of IP assets to the benefit of a debtor’s creditors and other constituencies.

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I. INTRODUCTION

Corporate control—how authority over the corporation and its assets is allocated among various corporate constituencies—is the central concern of corporate law. In addition to the issue of priority, corporate control also has become a core concern of bankruptcy law, particularly when it comes to corporate reorganizations under Chapter 11.1 As Professors Baird and

Rasmussen have noted: “Investors care intensely about ensuring that control of a firm’s assets reside in able hands in good times; they care even more in bad times. When a firm is in financial distress, a large part of its value can be lost in a short period of time.” When allocating control over a firm, the challenge is to identify and give control to those who have an incentive to maximize the firm’s value as a going concern, or at least to maximize the recovery upon a sale of assets. This is no easy task, as Professor LoPucki has stressed, because it may be difficult to identify a clear residual claimant when a company is bankrupt. Arguments have been made for placing control over a debtor and its assets in the hands of any number of constituencies, including management, shareholders, secured creditors, general unsecured creditors, debtor-in-possession lenders, and the bankruptcy judge. Instead of picking any single constituency to control the firm, different interests could share control, either as a matter of law or simply as a matter of bankruptcy practice. However, sharing control brings its own costs. As more parties have a say over a debtor and the use or disposition of its assets, delay, coordination problems, and other transaction costs can increase substantially.

The question of control rights in bankruptcy is especially important when it comes to intellectual property (“IP”) rights. Bankruptcy proceedings do not compromise fundamentally the value of most tangible assets. Tangible assets generally retain their value both during and after bankruptcy proceedings, although there is always the risk that the business will be run poorly. IP is different. IP rights are typically most valuable when they carry a credible threat of injunction. However, as a result of the delay and coordination problems inherent in the bankruptcy system, a
debtor’s IP rights may be under-enforced against infringers, even if the
debtor-in-possession or trustee-in-bankruptcy has the proper incentive to
pursue actively the enforcement of the debtor’s IP rights in bankruptcy.
Further, there is some risk that a major transaction over the debtor’s IP
could fail to occur in bankruptcy. Consequently, the bankruptcy process
itself potentially can eliminate all, or at least a substantial portion, of the
value of IP rights.

To ensure that a debtor’s IP rights are enforced vigorously, a party with
the right incentives, information, and resources, as well as with standing to
sue, needs control over IP assets in bankruptcy. Some might suggest that
modern bankruptcy practice already has become, or is increasingly
becoming, sufficiently streamlined so that the delay and coordination
problems of the bankruptcy process do not present serious concerns for the
enforcement of IP rights. However, the extent of the impact that such
procedural improvements might have on ensuring the value of IP rights in
bankruptcy is debatable.

Two possible options for addressing bankruptcy delay and coordination
problems are prepackaged bankruptcies and assignments for the benefit of
creditors. We offer another choice: the creation of a separate bankruptcy-
remote special purpose entity (“SPE”). Along the lines of a traditional
securitization of receivables, we explain how a company could attempt to
keep its IP assets from ever entering its bankruptcy estate by, at an earlier
stage in the company’s life cycle, selling its IP assets to an SPE. The SPE
would exercise control over the IP assets, including having the authority to
seek injunctions against infringers. By keeping a debtor’s IP assets out of
what would become its bankruptcy estate, the SPE structure would
mitigate the delay and coordination problems of bankruptcy, thereby
preserving the value of the IP. A properly structured SPE will have the
critical attribute that a holder of IP must have to ensure the value of the IP:
the credible perception by all market players that the SPE can enjoin
infringers of the IP and can transact over it.

One of the most important concerns that the IP securitization structure
raises is rooted in the corporate form and the limited liability of
shareholders. Some observers have worried that the combination of
limited shareholder liability and so-called “judgment-proofing”
transactions—such as a plain vanilla securitization of receivables or, by
extension, an IP securitization—will spell the unfortunate demise of legal
liability. We explore why the news of the demise of legal liability might
be overstated, and so too may be its impact. In short, the costs of greater
legal protection for creditors may outweigh its benefits. Moreover, when it
comes to IP assets in particular, in many instances, an IP securitization is
likely to increase the size of the corporate pie available to all corporate constituencies, even though the IP assets have been transferred to a bankruptcy-remote SPE. At a more general level, the greater certainty and predictability that arises when the legal system allows parties to privately order their affairs can encourage market entry and contracting in the first place, by both entrepreneurs and financiers.

This Essay proceeds as follows. Part II explores the role IP plays in commercialization in general and the interface between IP and bankruptcy in particular. Part II also discusses the IP securitization structure. Part III considers the potential death of legal liability and its implications for IP securitization or other judgment-proofing structures that are said to remove valuable assets from a debtor’s bankruptcy estate. Part IV concludes.

II. IP AND COMMERCIALIZATION

The public benefits from IP when IP operates to increase access to the subject matter it protects by facilitating commercialization.\(^5\) IP rights facilitate commercialization by helping the many complementary users of the subject matter IP protects coordinate with each other in bringing the subject matter to market. Coordination is facilitated in this way when IP rights are enforced by property rules (i.e., when IP rights are backed by the credible threat of an injunction and enhanced damages for willful infringement).

When IP rights serve their coordination function, they facilitate market entry by new businesses and promote transactions over IP. However, the coordination function of IP rights can be undercut if a holder of IP enters bankruptcy. To be sure, bankruptcy protection can promote an important economic end in that bankruptcy can facilitate the redeployment of resources to higher and better uses by paying off claimants to those assets in an orderly fashion and by allowing a debtor the breathing room to reorganize as a viable firm. Yet, the uncertainty and delay of a bankruptcy proceeding can themselves frustrate business and financial dealings, including those involving IP.

Bankruptcy law generally treats IP as just another asset in the debtor’s bankruptcy estate.\(^6\) However, the particular features of IP that distinguish


\(^6\) There are some exceptions in which IP is treated differently. For example, § 365(n) of the Bankruptcy Code allows a licensee of IP assets to continue to operate under its license despite its
it from other forms of property, such as factories, equipment, and real estate, raise some potentially serious problems for the IP/bankruptcy interface. Most tangible assets have ongoing value both during and after bankruptcy proceedings. IP rights may not. The general approach to bankruptcy, designed with non-IP assets in mind, purposely alters control over the assets of the bankruptcy estate in at least two important ways: first, more stakeholders have a greater degree of formal, or at least de facto, control over the debtor and the use of the debtor’s assets than occurs outside bankruptcy; and second, decision making is often slowed down in bankruptcy, at least with respect to significant matters. While collective choice and delay, in many instances, can allow for a fairer distribution or a more effective reorganization of a debtor’s assets, collective choice and delay turn out to present unique risks for IP assets as compared to most business assets. More to the point, because the value of IP rights is so closely tied to the extent to which they carry a present credible threat of injunction against others for infringement, the delay and coordination problems of bankruptcy can reduce materially both the private and public value of IP rights, perhaps toward zero.

Several tools may be available to prevent the value of IP rights from being dissipated through the bankruptcy process; but one tool often overlooked is a bankruptcy-remote special purpose entity.

A. Property Rights in IP Facilitate Commercialization

Although several major theories have been offered for how IP rights should operate, this Essay focuses on the commercialization theory of IP because it is one theory that focuses on a goal that IP actually can achieve effectively and efficiently. Many of the ideas that follow have been discussed at length elsewhere, so we can be brief here.

The incentive-based, or reward, theory of IP sees IP as a form of positive inducement for a particular behavior, such as the creation of the subject matter protected by IP. There are several shortcomings to this...
theory. First, because much of the desired activity occurs without reward, rewards may not be needed. Second, because much of the desired activity might not be responsive to additional reward, rewards may not be effective. Third, IP law is not adaptable to being finely tuned to create optimal incentives because of difficulties in determining the appropriate reward. Finally, the reward theory fails to explain much of the positive IP law framework.10

The prospect, or rent-dissipation, theory sees IP as a tool for coordinating among competing users of the subject matter protected by IP in order to avoid rent dissipation by the users as they race to develop or deploy the subject matter.11 There are several shortcomings to this theory as well. First, rent dissipation itself may not be a problem for IP. A number of factors other than IP, such as risk aversion and opportunity cost, may mitigate rent dissipation.12 Further, unlike racing for a single prize, racing to invent often yields multiple solutions, and the existence of a range of goods, services, and processes to choose from is itself beneficial. Second, IP rights are likely to be ineffective in mitigating any net rent dissipation that does occur because the stronger the IP right is in coordinating to prevent downstream rent dissipation, the more valuable the grant of an IP right is, which would increase the rent dissipation effect among those upstream who are racing for that right. Third, as with the reward theory, the prospect theory fails to explain much of the positive law IP framework.13

In contrast to the reward and prospect theories, the commercialization theory of IP explains the positive law IP framework, and is tied to a goal that is desirable and that can be achieved effectively and efficiently.14 IP law facilitates commercialization by forcing parties to negotiate with each other under the threat of suits for infringement.15 That is, the IP right serves as a focal point, or beacon, for coordination among the many

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10. For more on limitations of the reward theory, see Kieff, supra note 5, at 705–17.
14. See Kieff, supra note 5 (discussing positive law rules for enforcing patents); Kieff, supra note 13 (discussing positive law rules for obtaining patents).
15. See generally Kieff, supra note 5, at 727–32.
complementary users of the subject matter it protects, such as inventors, financiers, employees, managers, and marketers. This, in turn, facilitates the downstream commercialization of the subject matter IP protects.16

For IP rights best to facilitate coordination, the rights must be recorded publicly, must be capable of being the subject of diverse transactions for sale and license, and must be enforced by property rules. Centralized public recordation, such as through the patent, trademark, and copyright offices, decreases information costs for third parties as well as for all those engaged in the commercialization process.17 The availability of diverse transactions for sale and license gives those engaged in the commercialization process the incentive and ability to push output toward full competitive levels through their particularized arrangements.18

Most importantly, IP rights must be enforced by property rules, as distinct from liability rules. To put it more concretely, IP rights must be treated as an absolute right to exclude backed by the remedies of injunction and the potential for enhanced damages in cases of willful infringement.19 As recognized by Professors Haddock, McChesney, and Speigel, the threat of a potential onslaught of infringements induced by a liability rule can discourage investments in the subject matter covered by IP rights ex ante.20 Liability-rule treatment can also undercut contracting among holders of IP rights and potential licensees as potential licensees attempt to grab IP rights instead of contracting for them. Consequently, property rules are particularly important because of their impact on each potential infringer in reducing the incentive to infringe, in addition to the compensation property rules might confer on the holder of IP rights.21

Like all markets, markets for IP are imperfect. Because some breakdowns will occur, some liability-rule treatment of IP rights will be warranted.22 Indeed, the limited liability rooted in corporate law and bankruptcy law, when combined with the transaction costs of civil

16. Id.
17. See Kieff, supra note 13.
19. See Kieff, supra note 5, at 732 (discussing property-rule treatment).
20. Id. at 733 (citing David Haddock et al., An Ordinary Economic Rationale for Extraordinary Legal Sanctions, 78 CAL. L. REV. 1, 16–17 (1990)).
21. Id. at 734 (citing Haddock et al., supra note 20, at 13).
procedure, create some degree of liability-rule treatment for IP rights. Shareholders, managers, and employees, for example, may individually benefit while their company infringes another’s IP rights without any fear of personal liability given the costs and delays of civil litigation, the limited shareholder liability of the corporate form, and the protection afforded by the bankruptcy process.

Although each potential infringer enjoys liability-rule treatment to an extent, otherwise treating IP as property rights enforced by property rules facilitates the private ordering that is needed for coordination, and accordingly commercialization, to occur.

B. IP in Bankruptcy

Bankruptcy raises a central problem for IP that it does not raise in the same way and to the same degree for other assets, such as land, equipment, factories, or most other tangible assets. IP rights dissipate over time, and, when in force, their core private and social value is tied to the certainty of the IP holder’s right to exclude. Bankruptcy proceedings operate relatively slowly, collectivize control, and inject uncertainty. Each of these features of bankruptcy threatens to eliminate, or at least materially reduce, the value of an IP asset.

1. Bankruptcy: Delay, Collective Choice, and Uncertainty

Bankruptcy proceedings begin with the filing of a petition. Filing for bankruptcy creates the debtor’s bankruptcy “estate,” which essentially includes the debtor’s property. The bankruptcy filing also triggers a powerful legal injunction called the “automatic stay,” which essentially stops any effort by creditors to remove assets from the debtor’s estate. Further, there are at least some limits on the authority of the debtor-in-possession or trustee-in-bankruptcy to exercise discretion over the debtor, particularly when it comes to making decisions outside the ordinary course of the debtor’s business. This is not to say that assets cannot be removed

23. See Kieff, supra note 5, at 734–36.
26. In Chapter 11 reorganization cases, the debtor often remains in possession of the estate, but the bankruptcy trustee may take control. See 11 U.S.C. §§ 1107, 1108. In Chapter 7 liquidation cases, the trustee winds up the estate. See 11 U.S.C. §§ 701–04. The problems this Essay explores are particularly germane to reorganizations and so they will be the focus of the discussion.
from the debtor’s bankruptcy estate or that non-ordinary course dealings cannot occur. It is to say, though, that efforts to engage in such transactions are shunted through the bankruptcy process. As a result, the bankruptcy process, most notably by giving the bankruptcy court and a debtor’s creditors and counterparties a seat at the table and, accordingly, influence over corporate decision making, injects delay, collectivization of control, and uncertainty in the way some assets of the estate will be used while the bankruptcy proceeding is pending. This can raise serious problems for IP assets, whose value is tied to the present credible threat of an injunction.

Delay alone can be a problem because IP rights can dissipate over time. Because trademark rights persist only so long as they are used consistently in commerce to embody goodwill, lack of use (or even different use of a mark) for whatever reason can destroy the particular mark. Similarly, while patents and copyrights enjoy a definite term by default—an average of 17 years from issuance for patents and almost 100 years for copyrights—an infringer could point to the non-enforcement by an IP holder of its patents or copyrights in relying on the doctrines of laches, implied license, and estoppel as a valid defense to a claim of infringement. In other words, the doctrines of laches, implied license, and estoppel, all of which are available to an infringer when an IP holder has failed for one reason or another to enforce its IP rights, can have the same effect as granting a free license to all infringers.

Collectivization of control over IP rights is problematic because it can create a tragedy of the commons in which the failure of any party with influence over corporate decision making in bankruptcy to accede readily to efforts to exclude infringers or engage in transactions can frustrate the enforcement of IP and the commercialization of the subject matter it covers. For these same reasons, a central lesson for IP transactions in general is that ownership should, if at all possible, be concentrated in a single party from the time the IP asset is created and throughout its existence.

Finally, uncertainty is a problem for IP because uncertainty in enforcement can effectively transform property-rule protection for IP

28. By statute, patents expire after 17 years on average (20 years from filing, and examination takes three years on average). For a brief discussion of the change from a 17- to a 20-year patent term, see CHISUM ET AL., supra note 9, at 898–900.
29. See, e.g., id., at 1118–42.
30. Kieff, supra note 5, at 735 (noting that for IP assets, co-ownership can create a tragedy of the commons because ownership in the asset only confers a right to exclude, not use) (citing ROBERT PATRICK MERGES, PATENT LAW AND POLICY 1228–36 (2d ed. 1997)).
We recognize that more needs to be known about the extent to which the problems discussed above are not only problems in theory but problems that actually occur in the real world. Informal observations of practitioners reveal that while some lawyers and their clients spend substantial resources structuring IP transactions around the types of bankruptcy concerns described above, others do not. In other words, even if the costs that bankruptcy poses for IP are not large on the whole, they do exist and are thus relevant to any consideration of the implications of bankruptcy for IP assets. To gain a richer understanding of the nature and extent of the problems bankruptcy poses for IP, it would be worth studying empirically specific disputes and transactions. For example, it would be helpful to understand better the extent to which bankruptcy increases infringement of debtors’ IP rights. Better information regarding how often, and under what circumstances, a debtor-in-possession or trustee-in-bankruptcy actually fails to bring and aggressively pursue infringement actions also would be useful. Relatedly, one could explore which corporate constituencies of a debtor instigate the bringing of infringement actions and how other constituencies react when an infringement action is urged. In particular, it would be useful to know more about the precise mechanisms by which efforts to enforce or transact over an IP asset that is part of a bankruptcy estate actually occur, including how such efforts are mounted and by what parties, how other constituencies respond and why, and what specific factors influence how these efforts play out. Further, it is important to have more systematic data regarding how often the defenses of laches, estoppel, and implied license are asserted by an alleged infringer against an IP right that has been tied up as part of a debtor’s bankruptcy estate and under what circumstances the defenses are successful. Finally, one could collect data concerning the extent to which parties shy away from entering into licensing arrangements with a debtor

31. See Ayres & Klemperer, supra note 22.
32. See supra notes 19–21 and accompanying text.
33. Although conversations with practitioners report the problem we explore to loom large in many cases, we are confident that in some instances, the problem gets solved. The one often cited example of a positive result is that transacting occurred with respect to Marvel Entertainment’s IP assets during bankruptcy. See, e.g., Gil Lahav, Licensing to the Rescue, IP L. & BUS., Feb. 2004, at 14.
34. One reason these defenses might not work is that courts might be less sympathetic to equitable defenses offered by infringers who have intentionally infringed. See, e.g., Hermès Int’l v. Lederer De Paris Fifth Ave., Inc., 219 F.3d 104 (2d Cir. 2000) (holding no laches in a counterfeiting case).
in bankruptcy or even with a company that is not yet bankrupt but that is financially distressed.

The bankruptcy system has evolved methods for facilitating ongoing IP transactions as the debtor’s business either wraps up or reorganizes in bankruptcy. For example, the basic strategy the bankruptcy system has adopted for executory contracts, like IP licenses, is to allow the debtor-in-possession or bankruptcy trustee to elect whether to accept, reject, or assign the contract. Bankruptcy law then protects the debtor’s licensee by giving the debtor’s counterparty rights to have the debtor “cure” or “provide adequate assurance” that the debtor will cure or perform and, in extreme cases, by granting motions to compel election or to “lift stay.” The Bankruptcy Code also gives some special treatment to IP licensees by allowing them to continue to operate under existing license terms when the IP owner is in bankruptcy. This Essay does not endeavor to enter the debates about the particular features of each statutory provision that bears on this process. Rather, this Essay addresses a different problem at the IP/bankruptcy interface.

That is, this Essay addresses the central importance to an IP right of the credible threat of an injunction. Because the value of an IP right largely is tied to the right to exclude, the value of an IP right is eroded unless there is a single party having sufficient legal interest, financial resources, and decision-making capacity to be a proper plaintiff with standing in a lawsuit. If such a putative plaintiff does not exist or faces hurdles or other disincentives in seeking an injunction against an alleged infringer, third parties have a rational incentive to infringe. This can significantly reduce the economic value of the IP right, both to the debtor and to any of its present licensees, as well as to the public at large to the extent future commercialization would be beneficial. The practical, and in some cases legal, obstacles of the bankruptcy process may compromise a debtor’s ability or inclination to enforce its IP rights strictly. More to the point, the bankruptcy proceeding can frustrate the coordinating function of IP rights,

40. See supra note 6.
creating a risk that what would be a common pool resource among all claimants on the assets of the debtor’s bankruptcy estate will lose its value.

2. The Prospect of a Bankruptcy-Remote SPE

One solution is to create a bankruptcy-remote SPE to hold a company’s IP assets as part of what we term an “IP securitization.” As discussed below, an IP securitization is very similar to a traditional asset securitization.

In a traditional asset securitization, a company, commonly referred to as the “originator,” sells receivables or other financial assets in a “true sale” to a bankruptcy-remote SPE, which issues securities to raise the funds required to purchase the originator’s assets. The SPE’s investors look to the assets the SPE purchased from the originator to satisfy the SPE’s obligations under the securities it issued. The SPE typically is an entity established and, at least to some extent, controlled by the originator.

In an asset securitization transaction, the originator in effect monetizes its assets, exchanging them for cash received from the SPE. Once the assets are sold in a true sale to the SPE, it is expected that the assets have been removed from what could become the originator’s bankruptcy estate; if so, the originator’s creditors cannot reach the transferred assets if the originator later seeks bankruptcy protection. To prevent the possibility that the originator will put the SPE itself into bankruptcy, the SPE’s organizational documents might require, for example, that the SPE have independent directors who have to consent to any bankruptcy filing. To reduce the risk that some third-party creditor will put the SPE into bankruptcy, the debt the SPE can incur is often limited, as is the business in which the SPE can engage.

In reality, things are not quite as clear-cut as suggested here. Rather, there is always some lingering (albeit minimal) risk that a true sale will be

42. For more on securitization, see Steven L. Schwarcz, Structured Finance: A Guide to the Principles of Asset Securitization (2002). In reality, the first SPE will often transfer the originator’s assets to a second SPE, which will then issue securities to finance the purchase of the originator’s assets. For more on this two-tier structure, see Schwarcz, supra, § 3:2:2. Securitization poses a number of other questions regarding the appropriate form of the SPE (e.g., whether it should be a corporation, a limited liability company, a trust, etc.). Securitization also raises a number of tax and accounting issues. Such matters are beyond this Essay’s scope, although it should be noted that practitioners have developed techniques and deal structures to address them.

43. A prominent example of a transaction in which IP assets were monetized is the so-called “Bowie bonds” deal. See Andrew Fraser, Bowie Rocking Wall Street; Investment: Entertainer Markets Bonds Tied to Music Royalties, Prudential Takes Them All, Long Beach Press-Telegram, Feb. 15, 1997, at E3.
recharacterized as a secured loan or that the bankruptcy court will otherwise disregard the bankruptcy-remote status of the SPE, such as through a substantive consolidation that consolidates the SPE and the originator. The asset securitization structure, in other words, minimizes bankruptcy risk but cannot totally eliminate it.

The general framework for an IP securitization is as follows. A company would transfer its IP assets in a true sale to one or more bankruptcy-remote SPEs (an “IP SPE”). The primary purpose of the IP SPE, as reflected in its organizational documents, would be to bring suits against potential infringers of the transferred IP assets and perhaps to license the IP to others. To finance the cost of litigation and of engaging in licensing transactions (e.g., hiring counsel), the IP SPE could issue securities. Alternatively, proceeds arising under licenses the IP SPE enters into could fund the IP SPE, or the originator could make capital contributions that finance the IP SPE. (It is important to note that although the IP securitization structure is not designed as a financing strategy as such, the originator may nonetheless retain a right to receive licensing fees that arise under any licenses the IP SPE enters into with third parties or receive fair value when it transfers assets to the IP SPE.) As in all asset securitizations, precautions must be taken to ensure the bankruptcy-remote status of the IP SPE.

This, then, raises the most challenging hurdle for IP securitization—namely, the corporate governance of the SPE. In a traditional asset securitization, the transferred assets are pre-existing receivables. The originator has no substantial ongoing interest in the assets themselves once they have been monetized, and the key task for the SPE is to service the receivables for its own account and the interest of the SPE’s investors. By contrast, an IP SPE must manage the IP assets, most notably by enforcing the IP assets against alleged infringers and possibly by engaging in transactions over the IP assets. Further, important constituencies of the originator, such as the employee-inventors/authors who created the IP

44. Although the separation of IP from the going concern of a business can raise a problem for trademarks because it can lead to the separation of the mark from the very things that embody the goodwill associated with the mark, the IP SPE we envision would include not only the trademarks but all of the IP of the business, including copyrights, patents, and other know how. As a result, the IP SPE will keep the trademark connected with these other components of the business needed to generate the goodwill.

45. The monetization of IP assets is already common, the best example being the “Bowie bonds” referred to supra note 43.

46. See, e.g., SCHWARCZ, supra note 42, at ch.3 (discussing strategies for ensuring that an SPE is bankruptcy remote).
assets initially, may have a continuing interest in ensuring that the IP is commercialized. More importantly still, the transferred assets may be key assets that remain important in running the originator’s business, unlike a stream of receivables that has already been monetized upon the initial transfer to the SPE. Accordingly, in an IP securitization, the originator may itself be a licensee of the transferred assets and may otherwise desire to continue to exert meaningful control over the IP SPE and its management of the IP assets. While it is not difficult to negotiate and structure governance arrangements over the IP SPE that accommodate an originator’s desire for ongoing control, such arrangements reintroduce a bankruptcy risk that jeopardizes the entire IP securitization structure. The more control the originator exerts over the IP SPE, and the more it appears as though the originator has an ongoing ownership interest in the transferred assets, the greater is the risk that a bankruptcy court will determine that the IP SPE is not bankruptcy remote and that the transferred IP assets are in fact part of the debtor’s bankruptcy estate.

Similar questions of control over the SPE arise in the context of a “whole company securitization” (i.e., the securitization of the current and future revenue stream of a company’s important operating assets, if not its entire business) and a “future flow securitization” (i.e., the securitization of future receivables that do not exist when the transaction closes and which therefore depend on the future operation of the originator’s business). The common denominator among whole company securitizations, future flow securitizations, and IP securitizations is that the key assets in the transaction must be managed effectively going forward to reduce business risks, to maximize cash flows, and to maintain the value of the transferred assets. In short, in these structures, as compared to


traditional asset securitizations involving pre-existing receivables, the SPE’s corporate governance is especially important.

The principal benefit of the IP securitization structure is not as a financing option for the originator, but that in separating the originator’s IP assets from the originator if it were to file bankruptcy, the IP securitization structure better ensures the proper enforcement of the IP rights and the commercialization of the assets. By insulating an originator’s IP assets from inclusion in its bankruptcy estate and by more clearly allocating control over the IP SPE, and thus the IP assets it holds, an IP securitization would mitigate the delay and coordination problems of bankruptcy. A properly-structured IP SPE will have the critical attribute that a holder of IP assets must have to ensure the value of the IP assets: the credible perception by market participants that the IP SPE can enjoin infringers of the IP assets and can transact over them. IP securitization, then, reduces bankruptcy risk with respect to the transferred IP assets. The IP SPE would continue to enforce the IP rights it holds, as those assets are kept outside the debtor’s bankruptcy estate. And the debtor, if a licensee of the IP SPE, as well as any third-party licensees of the IP SPE, would continue to have access to the IP rights without those assets being ensnared in the bankruptcy process.

If the IP remained in the debtor’s bankruptcy estate, the value of the assets might decrease substantially as a result of the bankruptcy process; having kept the assets in the estate, therefore, could work to the detriment of all corporate constituencies, including the reorganized debtor if it emerges from Chapter 11, and could frustrate ex ante transacting over the IP with potential licensees. Transferring the IP assets to an IP SPE helps preserve the value of the assets; and the originator, including its creditors, benefits from any proceeds the originator receives in the sale of the IP assets, from any rights the originator has in the IP assets as a licensee, and

49. Precedent already exists for structures, such as we outline in this Essay, designed to keep a debtor’s IP assets out of bankruptcy. An IP licensee, for example, sometimes requires its licensor, particularly where the licensor is a new or financially-strapped company, to transfer the licensor’s IP to an SPE so that the licensor, if it later files bankruptcy, cannot reject the license as an executory contract. See, e.g., Richard M. Cieri & Michelle M. Morgan, Licensing Intellectual Property and Technology from the Financially-Troubled or Startup Company: Prebankruptcy Strategies to Minimize the Risk in a Licensee’s Intellectual Property and Technology Investment, 55 BUS. LAW. 1649 (2000); Scott J. Lochner, Risk-Minimization Strategies in Licensing Intellectual Property from Entities That Are, or Might Become, Financially Troubled, 14 J. PROPRIETARY RTS. 7 (2002). In such instances, the licensee contracts with the bankruptcy-remote SPE and not the original IP owner (i.e., the future debtor). A licensor, of course, could adopt the same strategy by having its licensee establish an SPE that contracts with the licensor to mitigate the risk that the licensee, if it later files bankruptcy, will reject the license as an executory contract. What have been overlooked are the more general issues of control and the resulting commercialization benefits of an IP securitization.
from any income the originator receives under any licenses the IP SPE enters into with third parties.\textsuperscript{50} Indeed, by reducing the bankruptcy risk faced by third-party licensees, the IP securitization structure can promote IP-related transactions and, accordingly, increase cash flows to the originator both before and after bankruptcy.

We recognize that the debtor-in-possession or bankruptcy trustee has wide discretion to act in the ordinary course of the debtor’s business in bankruptcy. However, there is still the risk that the debtor’s IP assets will get tangled up in the administration of the debtor’s bankruptcy estate. The risk does not need to be great for companies and their advisors to turn to options for mitigating it. At the very least, as outlined above, there could be delays in enforcing the debtor’s IP rights against putative infringers, as well as disputes over whether and on what terms to license the IP. Indeed, if the debtor’s IP constitutes a substantial portion of the estate, there is at least an argument that entering into licensing arrangements or suing for infringement might fall outside the scope of the debtor’s ordinary business, in which case creditor notice or bankruptcy court approval could be required.\textsuperscript{51} Plus, as noted earlier, third-party licensees of IP would prefer if the licensed IP were never part of a debtor’s bankruptcy estate.

The bottom line point is that IP securitization reduces whatever risk is associated with the debtor’s IP assets being part of the debtor’s bankruptcy estate, just as traditional asset securitization reduces the bankruptcy risk associated with secured debt.\textsuperscript{52} The marginal reduction of bankruptcy risk is important.

Whatever the merits are of IP securitization, there are at least two sources of market resistance that the structure would have to overcome to be implemented in practice. First, the IP securitization structure is untested in bankruptcy. The risk that a bankruptcy court, sitting in equity, will disregard the bankruptcy-remote status of the IP SPE jeopardizes the soundness of the entire structure. As compared to a traditional securitization of receivables, a bankruptcy court is more likely to disregard

\textsuperscript{50} In any case, as among the group that includes the debtor and each of its corporate constituencies, some are better off and none are worse off.

\textsuperscript{51} For the same reasons as those discussed above, see supra notes 30–34 and accompanying text, it would be useful to move beyond casual empiricism to conduct more rigorous empirical research to determine more accurately how frequently, and under what circumstances, disputes arise over whether the efforts of a debtor-in-possession or trustee-in-bankruptcy to enforce or transact over IP rights falls within the scope of the ordinary course of business.

\textsuperscript{52} Similarly, as noted above, notwithstanding the protections that § 365(n) of the Bankruptcy Code provide to licensees of IP assets, many licensees nonetheless negotiate for their licensor to transfer the assets into a bankruptcy-remote SPE to reduce the risk that the debtor-licensor will reject the license as an executory contract. See supra note 49.
an IP SPE’s bankruptcy-remote status and to substantively consolidate it and the originator because of the degree of control the originator is likely to exert over the SPE and because the contested IP assets, particularly if used in running the business, may be key to the originator’s reorganization in a way that a stream of receivables is not. To avoid such legal uncertainty, parties may simply steer clear of such transactions.  

The LTV Steel case drives home the problem of legal uncertainty in this context. In December of 2000, LTV Steel Company (“LTV”) filed for relief under Chapter 11 of the Bankruptcy Code and in so doing, challenged the structure of two asset securitizations in which it had engaged, arguing that the transactions should be characterized as secured loans and not true sales. LTV sought to haul back into its bankruptcy estate the assets it had transferred to two SPEs. In particular, LTV sought to use the assets as cash collateral. The LTV Steel court cast significant doubt on the bankruptcy-remote status of the SPEs, holding that LTV “has at least some equitable interest” in the SPEs’ assets and “that this interest is property of [LTV’s] estate.” The court went on to say that the “entry of the interim order [allowing LTV to use the assets as cash collateral] was necessary to enable [LTV] to keep its doors open and continue to meet its obligations to its employees, retirees, customers and creditors.”

The second hurdle for the IP securitization structure to overcome to achieve acceptance in business and finance circles is the stigma left by Enron’s collapse. SPEs have earned a bad name among some as a result of Enron’s use of the vehicles to inflate earnings and shed debt from its balance sheet. In the post-Enron era, companies, along with their financial advisors, accountants, and legal counsel, may tend to resist the use of new types of SPEs in corporate structures.

53. Notably, Delaware has attempted to mitigate the legal risk surrounding securitizations by adopting the “Asset-Backed Securities Facilitation Act,” which, by characterizing what constitutes a true sale under Delaware law, attempts to shore up an SPE’s standing as a bankruptcy-remote entity. DEL. CODE ANN. tit. 6, § 2701A–2703A (Supp. 2004); see also SCHWARCZ, supra note 42, at § 4:12.


55. Id. at 280–81, 285.

56. The assets at issue included inventory and receivables that LTV had transferred. Id. at 280.

57. Id.

58. Id. at 285.

59. Id. at 286. In the case of an IP SPE, the first issue is likely to obtain, although the second issue can probably be avoided since the originator will presumably enjoy a license.

Even after Enron fades from memory, as it inevitably will, the use of the IP securitization structure will depend on the willingness of various parties to step up as early movers in structuring and entering into such deals. Lawyers, bankers, investors, and CFOs are often more comfortable following instead of leading when it comes to innovative new structures because of the attendant risks.\textsuperscript{61} That having been said, if there is enough money to be made, path dependence and risk aversion can be overcome. After all, somebody was first when it came to the securitization of receivables, leveraged buyouts, junk bonds, swaps, contingent convertible bonds, and so on.

Outlining, as we have, why the IP securitization structure is a viable alternative for mitigating bankruptcy risk and facilitating the commercialization of IP, however, is not the end of the story. IP securitization, like traditional asset securitization, raises a concern that should be addressed in evaluating this structure—namely, the implications of the IP securitization structure for legal liability, a topic to which we now turn.

\section*{III. On Bankruptcy, Limited Liability, and Judgment Proofing}

The overarching purpose of bankruptcy is to maximize the asset pool to which creditors can turn and to ensure that the debtor, if it so chooses, is able to continue as a going concern. To this end, a bankruptcy filing triggers the creation of the debtor’s bankruptcy estate and the automatic stay, which keeps creditors from rushing to grab assets so that the debtor can be liquidated under Chapter 7 or reorganized under Chapter 11 in a more orderly and coordinated fashion. Once a company is in bankruptcy, there is often a search for assets that, although at first blush appear to fall outside the debtor’s bankruptcy estate, might be included in it to satisfy creditor claims or to facilitate the debtor’s emergence from Chapter 11 as a viable company. The avoidance of preferences and bans on fraudulent conveyances are examples. More controversial ways to enlarge the

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debtor’s bankruptcy estate by vitiating the corporate form itself include piercing the corporate veil to reach the assets of the debtor’s shareholders and other doctrines and judicial approaches, such as substantive consolidation, that in effect unwind or collapse corporate structures. 62

More to the point, observers have worried that the combination of limited shareholder liability 63 and so-called “judgment-proofing” transactions will spell the demise of legal liability. 64 The particular concern with limited liability is that it creates an incentive for corporations to take excessive risks because the downside the corporation and its shareholders face is capped. Limited liability can also have distributional consequences in that certain creditors may be left holding unsatisfied claims. The concern heightens when corporations can engage in judgment-proofing transactions designed to take advantage of limited shareholder liability and the law’s respect for corporate structures in order to separate

62. For a good summary, see, e.g., Steven L. Schwarcz, Collapsing Corporate Structures: Resolving the Tension Between Form and Substance, 60 BUS. LAW. 109 (2004).


Our focus is on corporations; however, limited partners in a limited partnership and members in a limited liability company also enjoy the benefits of limited liability. Therefore, concerns about the death of legal liability would extend to these business associations as well.

an enterprise’s assets from its liabilities. Representative judgment-proofing strategies include sale-leasebacks, doing business through subsidiaries, franchising, off-shore asset sequestration, secured debt, and traditional asset securitization. The IP securitization structure would be another.

There is a longstanding debate among academics over limited liability and whether or not legal liability should be shored up. For example, LoPucki considers a number of “radical” (his word) recommendations to stave off liability’s death, including holding shareholders personally liable, giving involuntary creditors priority over secured creditors, expanding enterprise liability, holding those who transfer assets to a judgment-proof corporation liable, and extending liability to the debtor’s trading partners who do business with the company. LoPucki, Death of Liability, supra note 64, at 54–71. For another important article arguing for expanded shareholder liability, see Hansmann & Kraakman, supra note 63. But see Grundfest, supra note 63 (arguing that imposing additional liability on shareholders will simply increase transaction costs on both issuers and investors as capital markets design strategies to “readily arbitrage around” the price effects of expanded liability on shares). For an argument in favor of officer liability, at least with respect to a corporation’s tort liabilities, see Glynn, supra note 63.

Others who have trained their sights more squarely on secured debt, such as Professors Bebchuk and Fried, as well as Professor Warren, have argued that some collateral should be preserved for unsecured creditors. See, e.g., Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 YALE L.J. 857 (1996); Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics, 82 CORNELL L. REV. 1279 (1997) (hereinafter Bebchuk & Fried, Further Thoughts); Elizabeth Warren, An Article 9 Set-Aside for Unsecured Creditors, 51 CONSUMER FIN. L.Q. REP. 323 (1997). For one thoroughgoing response, see Steven L. Schwarz, The Easy Case for the Priority of Secured Claims in Bankruptcy, 47 DUKE L.J. 425 (1997).

Generally, it is far from certain that supposedly judgment-proofing transactions in fact render companies judgment proof. Schwarz, for example, has explained that at least in an arm’s-length transaction, the transferor in the deal has an incentive to get fair value in exchange for the assets it gives up. Schwarz, Inherent Irrationality, supra note 64; Schwarz, Rejoinder, supra note 64. But see LoPucki, Irrefutable Logic, supra note 64. In this view, it is only when and if the value received is paid out to shareholders that judgment proofing might occur.

Moreover, in considering whether or not judgment proofing is a problem, a comparison is worth noting. The concern with judgment proofing is that corporations, through a wide variety of familiar techniques, can place assets beyond the grasp of creditors in bankruptcy. But are judgment-proofing arrangements different in kind from a host of other ordinary-course transactions that dedicate or expend corporate assets in favor of particular corporate interests? For example, even when a company borrows on an unsecured basis, it commits to paying the lender principal and interest, and also is likely to agree to a host of affirmative and negative loan covenants that, ex post, can reduce firm value and cash flows. Indeed, the higher interest rate obligations associated with unsecured lending can themselves accelerate a company’s financial decline. Consider, further, long-term contracts that a company enters into with its suppliers or wage and benefit commitments management makes to employees, particularly to unionized workforces. The obvious retort is that each of these transactions maximizes firm value ex ante. However, the same can be said for judgment-proofing transactions. Even though judgment-proofing strategies might shrink the pool of assets available to certain creditors after the fact in bankruptcy, they can create more efficient and lower-cost financing options and corporate structures that expand the size of the corporate pie ex ante for all constituencies. Plus, if managers can freely sell corporate assets in the ordinary course of business and, with few restrictions,
consideration of limited shareholder liability and judgment proofing is beyond our present scope. We would, however, like to highlight a few points in the debate that we think cut against concerns that IP securitization might accelerate the death of legal liability. Because this is well-trodden ground, we will be brief and will paint with a broad brush.

First and foremost, many creditors are compensated up front for the risk they bear in extending credit to a corporation. Lenders, for example, can adjust their credit terms to deal with riskier borrowers by increasing the credit’s interest rate and negotiating tighter covenants. By bringing their own expertise to bear and by engaging sophisticated counsel and financial advisors, lenders have an opportunity to ensure that they appropriately price the risk they assume when extending credit. Beyond that, lenders often are able to diversify and hedge.

We do not want to overstate the virtues of such creditor self-help, however. Because of imperfect information, transaction costs, bounded rationality, and cognitive biases, creditors may not adjust appropriately a borrower’s credit terms in every case.68

Tort creditors in particular have no meaningful opportunity to negotiate credit terms. Accordingly, when considering limited liability and judgment proofing, attention tends to focus on tort victims. Yet, special focus on tort victims is at least somewhat misplaced. To some extent, tort victims have an opportunity to price risk and buy insurance, which is to say that many tort victims are somewhat akin to voluntary creditors insofar as they suffer harm as a result of a product or service they actually purchase. Especially with the Internet, consumers can research goods and services, as well as manufacturers, and when deciding what to buy and who to do business with, can price in relevant consumer safety information to the extent it is available and understandable. Further, businesses have an incentive to modify their products and services by taking consumer preferences into account in providing safer goods. So long as market failures, including the bounded rationality and cognitive biases of consumers, do not undercut such market pressures, the need for legal liability is diminished.

Second, limited liability is often looked at from a “micro” perspective that emphasizes a debtor’s incentive to externalize risk by engaging in excessively risky conduct. A “macro” perspective, on the other hand,

68. For more on so-called “nonadjusting” creditors, see, e.g., Bebchuk & Fried, Further Thoughts, supra note 67, at 1295–1314.
looks at limited liability as part of broader economic policy. From this vantage point, the problem with creditor protectionism policies rooted in extending legal liability, let alone more substantive regulation of business conduct, is that such policies risk compromising economic growth and may even accelerate the demise of struggling companies by restricting sources of capital.69

For example, the risk of tort liability can chill the kind of innovation, risk-taking, and entrepreneurialism on which the U.S. economy depends and can otherwise “tax” economic activity.70 Expanding legal liability, whether it is by reaching the personal assets of shareholders or disregarding corporate structures, could have an {\textit{in terrorem}} effect in chilling economically beneficial behavior. Because it is hard to price regulatory and legal uncertainty, companies might reasonably respond by being overly cautious, in effect internalizing too much risk.

Furthermore, regulatory and judicial restrictions on financial arrangements and corporate structures can limit the pool of capital, drive up the cost of capital, and lead to operational inefficiencies. The complex and diverse capital and corporate structures of companies evidence the importance of private ordering to how businesses are financed and run. One way to respect such private ordering is to treat bankruptcy law as a default regime that companies can expressly contract around or at least structure around through techniques such as IP securitization.71

69. See Schwarcz, supra note 67, at 431–32 (explaining that the “availability of secured credit provides liquidity, which reduces the chance of debtor bankruptcy and thereby increases the expected value of unsecured claims”).

70. Cf. Grundfest, supra note 63, at 424 (explaining that limited shareholder liability may be a “necessary evil”). One study shows that direct tort costs in the United States totaled approximately $246 billion, or over 2.2% of GDP, in 2003. See TILLINGHAST-TOWERS PERRIN, U.S. TORT COSTS: 2004 UPDATE, TRENDS AND FINDINGS ON THE COSTS OF THE U.S. TORT SYSTEM (2004) (defining tort costs to include benefits paid or expected to be paid to third parties (i.e., losses), defense costs, and administrative expenses). Based on 2000 figures, the Council of Economic Advisors estimated that “excessive” tort costs—roughly speaking, direct tort costs minus actual economic damages, actual non-economic damages, and reasonable costs to administer the tort system—imposed a cost on the U.S. economy that was in the range of a 2% tax on consumption, a 3% tax on wages, or a 5% tax on capital income. COUNCIL OF ECONOMIC ADVISORS, WHO PAYS FOR TORT LIABILITY CLAIMS: AN ECONOMIC ANALYSIS OF THE U.S. TORT LIABILITY SYSTEM (2002).

71. Prepackaged bankruptcies are another option for contracting around bankruptcy law. For more on prepackaged bankruptcies, see, e.g., Baird & Rasmussen, Chapter 11, supra note 1; Baird & Rasmussen, Control Rights, supra note 1; Baird & Rasmussen, The End of Bankruptcy, supra note 1; LoPucki, supra note 1.

A number of leading bankruptcy scholars, including Elizabeth Warren, Lucian Bebchuk, Barry Adler, Robert Rasmussen, Alan Schwartz, and Lynn LoPucki, have analyzed the extent to which parties should be allowed to contract around bankruptcy law. A broad inquiry into the extent to which bankruptcy law should be optional or immutable is beyond our present scope. For a recent article that provides an excellent discussion of the issue and a useful overview, see Elizabeth Warren & Jay
The third point concerns a link between the theory of the firm and corporate governance, on the one hand, and limited shareholder liability, on the other. It has been argued that if shareholders faced greater liability, they would want greater control over the business. This could undercut capital formation. It would be harder for founders of businesses who are reluctant to relinquish control to raise capital. Plus, shareholders may not have the expertise needed to run the business. In addition, in many instances, would-be shareholders would simply search for other investment opportunities that allow them to be more passive, limiting the funds that are put to work as equity. More subtly, in competing to raise funds, managers and entrepreneurs might respond by committing to strategies that reduce shareholder risk and therefore the need for shareholder monitoring and control; but in doing so, they may bond themselves to overly cautious business strategies.

Finally, important law and judicial doctrines presently shore up legal liability. These include bans on fraudulent conveyances, the doctrine of substantive consolidation, prohibitions on preferences, veil piercing, director and officer fiduciary duties in the zone of insolvency, and enterprise liability. Market pressures can also cabin risky conduct as companies have an incentive to provide safe goods that consumers demand. Further, the agency problems that corporate governance addresses may mitigate risky corporate conduct if, as many claim, managers are risk averse in how they run the enterprise to protect their


72. See, e.g., Leebro, supra note 63, at 1587 (“Some justifications for limited liability have focused on the modern corporation and the separation of ownership and control. The argument is that no investor would accept unlimited liability when the actual management of the risk is in the hands of others.”); Manne, supra note 63, at 261–65 (stressing the efficiency of the specialization of function that characterizes the corporate form and its dependence on limited shareholder liability).

73. See, e.g., Easterbrook & Fischel, supra note 63, at 94–95 (discussing managerial bonding strategies in response to expanded shareholder liability). A different question is, why stop with shareholders if the decision is to extend liability? Why not look to other corporate constituencies that make up the firm to satisfy its obligations, at least under certain circumstances? Why allow some members of the production team to escape liability if shareholders do not? After all, all corporate constituencies enjoy limited liability, not just shareholders. Stephen Bainbridge has raised similar questions. See Stephen M. Bainbridge, Abolishing Veil Piercing, 26 J. CORP. L. 479, 498–99 (2001).

74. See generally Schwarz, Inherent Irrationality, supra note 64, at 32–48.

firm-specific human capital.\textsuperscript{76} Plus, managers might internalize an altruistic concern for others—sometimes called an “other-regarding preference”—that creates personal distaste for risky conduct that jeopardizes others’ well-being, even if taking more risk would be good for firm performance.\textsuperscript{77}

Concerns over too little legal liability, in other words, may be overstated. If liability does need further shoring up, a number of options exist, other than extending legal liability to additional parties or disregarding corporate structures.\textsuperscript{78} Three such options that have been offered include minimum capitalization requirements for firms, mandatory insurance for companies, and more stringent product safety regulation. Although these options have their own problems, they do have the advantage of mitigating many of the distortions and inefficiencies rooted in the uncertainty that would likely result if legal liability were extended through the judicial process, particularly if done so by courts cobbled together doctrines from corporate law, commercial law, bankruptcy law, and tort law to create a mix-and-match liability regime.\textsuperscript{79}

\textsuperscript{76} The CEO and other top executives, for example, may be risk averse in some instances to avoid jeopardizing their positions if the company were to land in bankruptcy. See Easterbrook & Fischel, supra note 63, at 107 (explaining that the “possibility of bankruptcy also represents a real cost to those with firm-specific investments in human capital”); Hansmann & Kraakman, supra note 63, at 1908 (explaining that managers “may manage in a risk-averse manner in order to lower the probability” of losses that “threaten their jobs” and thus may be “overdeterred by unlimited liability”); Leebron, supra note 63, at 1590 (“Managers will generally have less incentive that shareholders to increase the riskiness of the firm, since their human capital is typically heavily invested in the firm and might be severely damaged by the firm’s bankruptcy.”). Furthermore, shareholders generally do not suffer any reputational sanction when a company in which they hold shares receives bad publicity. Shareholders can simply sell and move on. The reputations of senior executives, however, do suffer. Thus, managers face a unique cost that shareholders do not bear.


\textsuperscript{79} See generally Kieff & Paredes, supra note 18. A more fundamental concern with extending legal liability through the courts is that juries and judges evaluate risk with the benefit of hindsight. As Judge Easterbrook put it when asking in Carroll v. Otis Elevator Co. why the design of an escalator, which allegedly injured the plaintiff in the case, should be a question for juries: “Come the lawsuit . . . the passenger injured by a stop presents himself as a person, not a probability.” Carroll v. Otis Elevator Co., 896 F.2d 210, 215 (1990) (cited and discussed in W. Kip Viscusi, Corporate Risk Analysis: A Reckless Act?, 52 STAN. L. REV. 563–64 (2000)). Moreover, juries and judges are not asked to account for the downstream incentive effects of imposing liability in a particular case. For more on juries, see, e.g., CASS SUNSTEIN ET AL., PUNITIVE DAMAGES: HOW JURIES DECIDE (2002); Hastie & Viscusi, supra note 78; Sharkey, supra note 78; Viscusi, Social Costs, supra note 75; Viscusi, Toward a
In sum, the costs of greater creditor protectionism may outweigh its benefits. To be sure, it might be nice if no creditor were left holding the bag when a corporation failed. But striving toward this end by shoring up legal liability in favor of creditors has its own costs. Limiting the liability of shareholders, as well as affording enterprises flexibility in structuring their operations and in innovating new capital structures, can maximize firm value ex ante, even if it means that certain creditors—including more sympathetic tort creditors—may be left with unsatisfied claims ex post. Further, when it comes to IP assets in particular, IP securitization might actually increase the size of the corporate pie available to all corporate constituencies.

IV. CONCLUSION

This Essay explores important interfaces shared by IP law, bankruptcy law, and corporate law. The consequences of corporate law and bankruptcy law for IP are particularly important because of IP’s special role in the economy when it comes to new businesses and productivity growth. To mitigate the risk that the bankruptcy process will ensnare a debtor’s IP assets, we offer a framework for IP securitization. The IP securitization structure predetermines who has control over a company’s IP assets if the company later enters bankruptcy. In other words, questions of corporate control over the IP assets are not left to the Bankruptcy Code or even to the bargaining process resulting in prepackaged bankruptcies. The possibility of allocating control through securitization helps preserve for the originator and potential third-party licensees the value of the originator’s IP assets by keeping them out of the originator’s bankruptcy estate and better enables an enterprise and its counterparties to decide for themselves on what terms to engage in business and finance without having their arrangements subject to the bankruptcy process. The greater certainty and predictability that arises when the legal system allows parties to privately order their affairs encourages business dealings in the first place, a point which is not limited to IP. If the deals that parties strike are enforced in bankruptcy, bankruptcy law can better facilitate business

*Diminished Role, supra note 75.*

Whatever their flaws, legislators and regulators are better equipped to take a broader perspective that views legal liability, risk management, and the tort system as part of economic policy generally. See Hastie & Viscusi, supra note 78, at 902 (explaining that risk management policy “requires an omnibus consideration of the distribution of cases, probabilities, benefits, and costs. In contrast, the tort jury trial focuses on a single case, sampled from only one of the four cells of a hypothetical risk analysis matrix: the too-few-precautions, harmful outcome cell.”).

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relationships and the creation of wealth ex ante, instead of primarily
serving as a means of winding up or reorganizing a firm ex post after a
bankruptcy filing.

To be sure, IP securitization comes at some cost, at least insofar as a
company’s creditors might be forced to shoulder additional risks and
harms that are uncompensated. When crafting the rules of the game,
lawmakers are challenged to strike balances in order to maximize social
welfare, while ensuring that no particular group shoulders a
disproportionate burden of the costs. Well-intentioned individuals, for
example, can in good faith disagree over how to balance the harms that
befall tort victims, on the one hand, and the importance of business and
financial innovation, on the other. In making these tradeoffs, though, it is
important to consider both sides of the ledger. It is also important to avoid
falling into the trap where the perfect becomes the enemy of the good.80 In
a world of scarcity, it is simply unavoidable that each person will in some
way be called on to subsidize larger social goals. Whether there should be
more or less legal liability, or more or less judgment proofing, is
ultimately a matter of comparative institutional analysis, to which we hope
this Essay has contributed.

80. FRANCOIS MARIE AROUET VOLTAIRE, DICTIOANNAIRE PHILOSOPHIQUE ("Le mieux est
l’ennemi du bien").