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REEXAMINING THE FIDUCIARY PARADIGM AT CORPORATE INSOLVENCY AND DISSOLUTION: DEFINING DIRECTORS' DUTIES TO CREDITORS

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In October of 1990, Chancellor William T. Allen of the Delaware Court of Chancery appointed Professor Stilson to serve as master pro hac vice *in a case of first impression in the United States. The case,* In re RegO Co.,[1] *involved the classic conflict between mass products liability claims and corporate dissolution law. RegO, a Delaware corporation, manufactured allegedly defective component parts to a liquified petroleum gas system. These defects had caused, and were projected to cause for decades into the future, personal injury and property damage to consumers. In* RegO, *a Delaware corporation elected to dissolve and wind up its business pursuant to newly-enacted and amended dissolution*

[1]623 A.2d 92 (Del. Ch. 1992).

statutes.[2] *Ostensibly, management pursued dissolution in order to preserve corporate assets against escalating litigation costs, insurance premiums, and judgments rendered in the products liability suits.*

The dissolution statutes, arguable "tort reformist" legislation, seemed to answer all the calls for reform by tort proponents. The statutes required: (1) "sufficient security" for all future unknown claims and/or claimants; (2) temporal parity among contingent and unknown claimants; and (3) pro rata payments for claims of "equal priority" to the extent the corporation had "insufficient funds" to pay "all claims and obligations in full." The "tort reform" theory, however, was unacceptable in practice. Indeed, the statute was so rife with ambiguity and risk-assumption by directors that it was amended in 1994. This article reflects Professor Stilson's perceptions on RegO *and the issue which the case left unanswered — the nature and scope of directorial duties to creditors in modern corporate jurisprudence.*

I. INTRODUCTION

The "directorial duty to creditors" exists as an apparent anachronism in present corporate jurisprudence. The duty is anachronistic in the sense that it was born out of the nineteenth century trust fund doctrine[3] and carried forward into the twentieth century without regard to the circumstances giving rise to its genesis.[4] As currently articulated, the duty to creditors arises upon dissolution[5] or insolvency[6] of the corporate

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[2]*Id.* at 94. *See* DEL. CODE ANN. tit. 8, §§ 280-282 (1991).

[3]*See* 16A WILLIAM M. FLETCHER, FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8217 (perm. ed. rev. vol. 1988) (permitting equity to create a "trust fund" upon the assets of a corporation for the benefit of stockholders and creditors); *see also infra* notes 359-420 and accompanying text (discussing the development of the trust fund doctrine).

[4]*See infra* notes 411-20 (tracking the application of the trust fund doctrine in the twentieth century).

[5]In a dissolution, the corporation is terminated, its assets liquidated, and the proceeds distributed to its creditors and stockholders according to statutory, contractual, or common law priorities. Dissolution has been described as

> a termination of the entity [that] ends its capacity to act as a corporate body. The remains, so to speak, may necessitate a liquidation and an extinguishment of all its prior relations in respect to the corporate enterprise, including the adjustment and payment of its debts, the distribution of its property or the sale of its property and the distribution of the proceeds. . . . The dissolution of a corporation is said to be that condition of law and fact which ends the capacity of the corporation to act as such, and necessitates a final liquidation and extinguishes all the legal relations subsisting in respect of the corporate enterprise. The dissolution intended by statutes governing the dissolution of corporations is a breaking up of the corporation. The

enterprise.[7] Unfortunately, present case law fails to provide managers with the tools for predicting exactly when insolvency occurs and, hence, when a duty to creditors exists.[8] Additionally, case law fails to address whether the duty to creditors gains ascendancy over, or operates as a complement to, traditionalist directorial obligations to stockholders.[9]

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term has its ordinary meaning of separation into component parts.

8 SEYMOUR D. THOMPSON & JOSEPH W. THOMPSON, COMMENTARIES ON THE LAW OF CORPORATIONS § 6415 (3d ed. 1927) (footnotes omitted).

[6]Insolvency is said to occur in one of two situations. The first circumstance giving rise to insolvency occurs when the corporation's liabilities exceed its assets and there is no reasonable expectation that the business can be continued ("bankruptcy" insolvency). Freeman v. Hare & Chase, Inc., 142 A. 793, 795 (Del. Ch. 1928). The second circumstance resulting in insolvency arises when the corporation is unable to pay its debts as they come due in the ordinary course of the business ("equitable" insolvency). *Id.*

[7]*See infra* note 36 and accompanying text; *cf. In re* Liberty Trust Co., 130 B.R. 467, 472 n.11 (Bankr. W.D. Tex. 1991) (noting the distinction between dissolution and liquidation under Texas law).

[8]*Compare* Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12,150, 1991 Del. Ch. LEXIS 215, at *108 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099, 1155 (1992) (articulating a directorial duty to creditors where a corporation is "operating in the vicinity of insolvency") *with* Geyer v. Ingersoll Publications Co., 621 A.2d 784, 787 (Del. Ch. 1992) (concluding that the fiduciary duty to creditors arises upon insolvency "in fact").

[9]"Traditionalist" corporate theory considers a corporation to be an entity separate from its owners, and thus independently liable for its contract and tort obligations. PHILLIP I. BLUMBERG, THE LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS § 1.01.1 (1983). Because traditionalist corporate theory recognized the independence of the corporate entity from its shareholders, management of the entity was placed in the hands of directors who were duly elected by the shareholders. *See* DEL. CODE ANN. tit. 8, § 141(a) (1991). Corporate law thereby separated the powers of the owners and managers to the entity. By dividing management from equity ownership, corporate law acknowledged the potential abuse of stockholders by directors. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (referring to the "omnipresent specter" of directorial self-interest). In response, corporate law imposes a fiduciary duty upon directors to act honestly and in good faith when carrying out the business affairs of the corporation (the duty of care). *See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360 (Del. 1993). Corporate law also requires directors to refrain from placing their own interests before those of the stockholders and the corporation (the duty of loyalty). Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985). A director's failure to fulfill these fiduciary duties can result in personal liability. *See, e.g.*, *id.* at 893 (finding directors personally liable for a breach of their fiduciary duty of care).

The entity theory of corporate law traces its history at least to mid-nineteenth century England. *See* BLUMBERG, *supra*, § 1.01.1. In the United States, the entity theory has received such widespread acceptance that corporations have been accorded many of the constitutional protections previously applied only to natural persons. *See, e.g.*, First Nat'l Bank of Boston v. Bellotti, 435 U.S. 765, 784 (1978) (corporation has a First Amendment right to freedom of speech); Hale v. Henkel, 201 U.S. 43, 76 (1906) (corporation is protected from unreasonable searches and seizures); Smyth v. Ames, 169 U.S. 466, 546 (1898) (corporation cannot have its

Finally, the parameters of this duty, and its correlative standards of judicial review, are nebulous.[10] Indeed, courts have not delineated whether the duty to creditors is akin to (1) the established corporate duties of care and loyalty;[11] (2) an informational obligation analogous to that of the corporate duty of disclosure;[12] or (3) an obligation coextensive with the contractual duties of good faith and fair dealing.[13]

Failure to fulfill their statutory or common law responsibilities may result in astounding personal liability for individual managers.[14] Therefore, precise delineation of the nature and scope of the duty owed to creditors is crucial to directors who must oversee the business affairs

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property taken without just compensation). *See generally* Note, *Constitutional Rights of the Corporate Person*, 91 YALE L.J. 1641 (1982).

The entity or traditionalist theory, however, has been the target of substantial criticism. For example, the Hohfeldian or "realist" theory of corporate law suggests that doing business in the corporate form is "nothing more than an association of such individuals." WESLEY N. HOHFELD, FUNDAMENTAL LEGAL CONCEPTIONS 197 (1923). Under a realist view of corporate law, therefore, owners of the corporation are liable for corporate debts.

Increasingly, corporate theory has moved away from the entity theory and in the direction of a contractarian model of governance. *See* BLUMBERG, *supra*, § 1.01.1. To contractarians (adherents to the Chicago school of economics), the traditional fiduciary model compromises the market for corporate control and thus impedes profit maximization to shareholders. Thomas L. Hazen, *The Corporate Persona, Contract (and Market) Failure, and Moral Values*, 69 N.C. L. REV. 273, 274-75 (1991). As a consequence, scholars adhering to the contractarian model consider the corporation to be a simple "nexus of contracts" which allows corporate constituents to contract freely concerning their relationship to, and rights against, the corporate persona. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976); *see generally* William W. Bratton, Jr., *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989). Accordingly, contractarian scholars argue that the fiduciary model should be eliminated in favor of market control through a contract model of corporate governance. *See* Hazen, *supra*, at 274.

[10]For purposes of this article, all references to corporate "duties" allude to judicially or statutorily imposed *standards of conduct* as opposed to the *standards of judicial review* under which they are judged.

[11]*See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1989).

[12]Zirn v. VLI Corp., 621 A.2d 773, 778 (Del. 1993).

[13]*See* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981) ("Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."); *see also* U.C.C. § 1-203 (1989) ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."). The term "good faith" is defined in the UCC as having subjective and objective attributes by requiring "in the case of a merchant . . . honesty in fact [(subjective and objective)] and the observance of reasonable commercial standards of fair dealing in the trade [(objective)]." U.C.C. § 2-103 (1989). The terms "good faith" and "fair dealing" are not defined in the *Restatement*.

[14]*See* ROBERT W. HAMILTON, CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS 727 (4th ed. 1990) (noting that the personal liability of directors in Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), amounted to $23,500,000).

of a corporation. Moreover, managers who wish to utilize recent developments in the jurisprudence of business organizations[15] must divine whether the duty to creditors is subject to contractual amendment. Consequently, a reliable characterization of the directorial duty to creditors is integral to directors who must satisfy both traditional and contractual[16] corporate obligations.

The ambiguities surrounding the duty to creditors are aggravated by several recent developments in Delaware. For example, current amendments to the Delaware General Corporation Law (DGCL) permit the contractual *elimination* of a director's liability for violations of the corporate fiduciary duty of care in specific situations.[17] Interestingly, however, an analogous "opt out" of directorial liability for the fiduciary duty of care is lacking for persons who manage other Delaware business organizations.[18] Conversely, the Delaware Revised Uniform Limited Partnership Act (DRULPA)[19] and the Delaware Limited Liability Company Act (DLLCA)[20] authorize modifications and amendments to the managerial duty of loyalty which, at present, is inviolable under Delaware corporate law. Based on these evidently conflicting statutes, Delaware managers, and their counsel, must surmise Delaware's adherence to traditionalist or contractarian precepts.

On the common law front, three recent decisions of the Delaware Court of Chancery exacerbate the conundrum of planning for managers of Delaware business organizations. First, *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*[21] seemingly imposes a

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[15]*See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1993).

[16]Contractarian theory considers the modern corporation to reflect a nexus of private ordering by the constituents to the firm. *See supra* note 9. Accordingly, contractarians support enforcement of corporate provisions which eliminate or restrict managerial duties and liabilities.

[17]DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 1993) (permitting a charter provision which eliminates or limits the personal liability of a director or officer to the corporation or its stockholders for monetary damages for breach of fiduciary duties if (1) the duty was not one of loyalty to the corporation or its stockholders, (2) the breach did not involve acts or omissions in bad faith or result from intentional misconduct, and (3) the alleged conduct did not result in an improper personal benefit to the officer or director).

[18]*See* DEL. CODE ANN. tit. 6, § 17-1101(d) (1993) (permitting only the restriction, and not the elimination, of directorial duties); *see also id.* § 18-1101(c)(2) (1993).

[19]DEL. CODE ANN. tit. 6, § 17-1101(d) (1993) (permitting the expansion or restriction of any of a partner's duties and liabilities by provisions in a partnership agreement).

[20]DEL. CODE ANN. tit. 6, § 18-1101(c)(2) (1993) (allowing the expansion or restriction of any of a member's or manager's duties and liabilities by provisions in a limited liability company agreement).

[21]No. 12,150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099 (1992).

directorial obligation to creditors where a corporation is "operating in the vicinity" of insolvency (thus extending directorial liability to a period pre-insolvency).[22] Second, *In re RegO Co.*[23] purports to exact a heightened standard of conduct from directors who elect to dissolve a corporate entity in the face of existing, contingent, and future unknown contract and tort claims, and thus extends directorial liability post-dissolution.[24] Finally, *In re USACafes L.P. Litigation*[25] creates a direct fiduciary relationship between directors of a corporate general partner and limited partners in a Delaware limited partnership,[26] and thus highlights the conflict between liability for misconduct by corporate managers and misconduct by partnership or limited liability company managers. Given these decisions, expanded use of contractual "opt out" provisions for managers of Delaware business organizations is likely.

This article addresses the duty to creditors from several perspectives. Part Two presents a hypothetical to examine the legal and practical implications of imposing a directorial duty to creditors. Part Three responds to the hypothetical by examining the statutory and common law alternatives available to our hypothetical directors. Part Four presents the theoretical arguments incident to a duty to creditors and the ramifications of its characterization in business organization law. The article concludes by advocating the abandonment of any corporate duty to creditors in favor of existing contractual obligations of good faith and fair dealing and common law actions for fraud. A corresponding abandonment of historical equitable doctrines is likewise suggested in light of equity's symbiosis with the duty to creditors. The article also recommends the adoption of a contractarian theory of corporate governance.

II. A HYPOTHETICAL ANALYSIS

A. *The Hypothetical Facts*

Assume a corporation is formed for the purpose of developing and manufacturing a product that will contain and aid in the removal of toxic waste spills. After five years in business, sales and profits are high, but the founders/directors of the business wish to disentangle themselves from the increasing stress of managing the company. Unfortunately, the

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[22] *Id.* at *108, *reprinted in* 17 DEL. J. CORP. L. at 1155.

[23] 623 A.2d 92 (Del. Ch. 1992).

[24] *Id.* at 106-07.

[25] 600 A.2d 43 (Del. Ch. 1991).

[26] *Id.* at 48-49.

corporation has experienced recent liability exposure due to a batch of their product that was inadvertently manufactured with latent, material defects. In fact, the corporation currently has five pending personal injury suits, as well as a $1 million property damage claim outstanding as a result of these defective products.

The founders wish to dissolve the corporation, liquidate its assets, and invest whatever money remains in a new venture. This new venture will pursue a streamlined manufacturing process for the original corporation's product. The company's assets are valued at $15 million and supplier debts are a modest $1 million. The founders fully intend to pay the $1 million property judgment. The founders are concerned, however, about recent scientific studies that indicate that their product is likely to fail and cause future accidents similar to those involved in the property damage and personal injury claims. According to these reports, the founders can easily anticipate personal injury claims with a present value of $12.5 million for the next fifteen years.

In pursuing the termination of the business, the founders wish to know what duty they owe to their existing, contingent, and future unknown creditors. Specifically, they ask whether they may sell the company assets at auction, declare a dividend prior to any dissolution, and use those funds to capitalize a new Delaware limited partnership or limited liability company. This new entity will engage in a similar business, but will eliminate all managerial liability to creditors in its partnership or liability company agreement.

B. *A General Commentary*

The death of a corporate enterprise (whether through dissolution or an insolvency which leads to liquidation) presents difficult planning questions for corporate directors and officers. One aspect of these planning questions concerns the rights of creditors upon the corporation's demise.

These planning questions are further complicated where the defunct, or soon-to-be defunct, corporation engaged in the manufacture of a defective product that caused, and continues to cause, personal injury or property damage years to decades after its manufacture. The future tort liability (liability tail) of the corporation may serve as the impetus for a voluntary dissolution[27] or may cause an insolvency without a

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[27]This "dissolution incentive" for corporate defendants has not gone unnoticed. *See, e.g.*, Mark R. Sarlitto, Note, *Recognizing Products Liability Claims at Dissolution: The Compatibility of Corporate and Tort Law Principles*, 87 COLUM. L. REV. 1048, 1052 (1987);

corresponding dissolution. In either case, the immediate dilemma posed to directors is how best to terminate the corporation, marshall its assets, pay its liabilities, and distribute any remaining monies to its stockholders.[28]

Clearly, the directors' decision to wind up the affairs of the corporation will be driven by a desire to minimize the future liability of the directors and shareholders of the business for products claims or for distributions made to the owners or managers upon liquidation.[29] On an instinctual level, one might advise the directors to dissolve the corporation and simultaneously to adopt a plan of distribution which would pay all existing and contingent contract and tort claims, as well as claims likely to arise within a reasonable time post-dissolution.[30] Any

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see generally Michael D. Green, *Successor Liability: The Superiority of Statutory Reform to Protect Products Liability Claimants*, 72 CORNELL L. REV. 17 (1986); Harry G. Henn & John R. Alexander, *Effect of Corporate Dissolution on Products Liability Claims*, 56 CORNELL L. REV. 865 (1971); Theresa A. Nuhn, *Continuing Corporate Existence for Post-Dissolution Claims: The Defective Products Dilemma*, 13 PAC. L.J. 1227 (1982); Mark J. Roe, *Mergers, Acquisitions, and Tort: A Comment on the Problem of Successor Corporation Liability*, 70 VA. L. REV. 1559 (1984).

[28]Dissolution law typically requires that liquidating distributions be paid to creditors before any payment is made to shareholders (the "absolute priority" rule). *See, e.g.*, 3 MODEL BUSINESS CORP. ACT § 14.05(a) (1994) (requiring that provision be made for discharging corporate liabilities before distributions may be made to shareholders). This absolute priority rule may be compromised where the dissolving corporation anticipates future products liability claims subsequent to the statutory bar date post-dissolution. Commentators have argued that a failure to observe the absolute priority rule in the circumstance of long-tail tort claimants "disturb[s] the correlation between social efficiency and maximization of shareholder wealth" and encourages the dissolution incentive without concern for product or consumer safety. Sarlitto, *supra* note 27, at 1064.

[29]Most jurisdictions have adopted statutes which supersede the common law rule that dissolution terminated the corporation's capacity to sue or be sued. *See infra* notes 306-29 and accompanying text.

[30]Identification of an interval during which the corporation or its successor will be liable presents one substantial difficulty in providing security for future unknown claimants in the dissolution process. Certainly, to whatever extent legislation requires protection for *all* foreseeable injuries, the monies appropriated to fund trusts or escrow accounts will be depleted on an annual basis by administrative costs, attorneys' fees, and costs of defending personal injury suits. It seems that such an extended freeze on assets becomes counterproductive at the point when costs and fees exceed the amount of monies being paid to legitimate claimants.

An alternative appears to be an independent bar date after which remaining resources must be distributed to claimants who previously received only a partial payment due to the anticipated, yet unrealized, future injury of another consumer. *See infra* notes 194-205 and accompanying text. This claims assertion date would not be considered a statute of limitations because the period of repose would not begin to run on the exact date of an injury or manifestation of an injury. *Id.* Instead, the claims assertion date would serve to balance the interests of anticipated future claimants, as well as those who have present injuries and who have not received full compensation. *Id.* An *ad hoc* claims assertion date depending on the

monies in excess of the distribution plan would inure to the corporation's equity holders.

One attraction of such a plan of dissolution and accompanying scheme for distribution is its certainty of payment to contracting parties and posting of security for pending, and reasonably foreseeable, claims and claimants. Within that zone of certainty are suppliers and creditors of the liquidating corporation that have provided goods or services for several years and that have developed an expectation of, and reliance upon, repayment. Tort claimants who are ascertainable as of the date of the corporate termination, or within a reasonable interval post-dissolution, also share in the zone of certainty.

A dissolution and distribution scheme that compensates, or provides security for, only the above-mentioned claims and claimants has a further advantage. Such an arrangement would redeploy capital and assets into the stream of commerce within a reasonable time post-corporate liquidation. The beneficiaries of this redeployment scheme are not only those individuals who are in existence at the time of the corporation's demise but also those who are in need of the capital anticipated to be released by the dissolved corporation upon liquidation. Finally, the known and reasonably foreseeable claim[31] plan of distribution would provide the economic incentive to corporate managers to negotiate the prompt settlement of contingent or short-term future claims in order to place corporate assets back into productive use.[32]

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nature of each case and the allegedly defective product would result in continuous review by the court of original jurisdiction at a cost that would often deplete assets beyond those available for distribution to claimants. *Id. Cf.* DEL. CODE ANN. tit. 8, §§ 280-282 (1994) (setting forth a 10-year bar date for unknown claims).

[31]"Foreseeable" claims are those which are not in existence at the time of dissolution or those which will manifest themselves during the post-dissolution winding-up interval but which are statistically foreseeable by the corporation at the time of dissolution, based upon the claims' history of the firm. Examples of future foreseeable claims include injuries resulting from exposure to asbestos, DES, electromagnetic fields, toxic chemicals, and use of defectively-manufactured products.

[32]Proponents for reform in the area of mass tort liability dispute such a combined dissolution and plan of distribution where it fails to provide relief for *all* future foreseeable claimants. To these proponents, corporate defendants who knowingly manufacture products with latent defects are chargeable for all resulting liability and, therefore, should not be able to evade that liability through a dissolution designed solely to limit long-term tort liability. *See* Green, *supra* note 27, at 49-58. The "corporate dissolution incentive," according to these proponents, should be eliminated through corporate legislation which requires some form of future protection for all delayed-occurrence injuries whether through mandatory trust funds, escrow accounts, or insurance. *Id.* at 50-51.

To these tort reform proponents, corporate statutory reform is mandated because liberalized successor liability law has proven an inadequate remedy for future products liability

Directors who wish to terminate a corporate enterprise in light, or because, of the company's products' history, therefore, face a legal dilemma: To what extent does corporate law impose an obligation upon directors to protect future unknown claimants who are, or foreseeably will be, plaintiffs injured as a result of products manufactured by the dissolved corporation. Because statistics may indicate a liability tail of several decades, directors must necessarily balance any provision made for contingent and prospective tort plaintiffs against the rights and needs of existing judgment creditors of the corporation.[33]

III. A RESPONSE TO THE HYPOTHETICAL

Fundamental corporate decisions that presently confront directors of dissolving or insolvent corporations necessarily weigh the rights of creditors against the redeployment of corporate assets for future economic gain. In the hypothetical, the founders/directors wish to dissolve the original enterprise in a manner that compensates creditors fairly but that preserves some assets for use in a new venture. The founders also wish to utilize recent amendments to the business organization law of Delaware to commence a new enterprise free from the creditor concerns which they now face.

In Delaware, directors have at least two options when considering dissolution of our hypothetical corporate enterprise. First, the directors can elect to proceed under sections 280 through 281 of the DGCL.[34] Alternatively, the directors can opt to precede dissolution with a sale of the firm's assets at auction, a settlement of all mature claims, and the payment of a liquidating dividend to stockholders from any surplus proceeds.[35]

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claimants. *Id.* at 41. For example, under traditional corporate governance models, a liquidating corporation may precede its dissolution with a sale of all, or substantially all, of its assets to another corporate entity in combination with an agreement between the constituent corporations that the selling corporation's liabilities will not follow its former assets. In this manner, corporate assets leave the dissolved entity in return for cash which will be applied to the payment of corporate debts. As a consequence, all future income generated by the dissolved company's former assets will accrue solely to the successor corporation. Corporate law thus allows a sale of assets to defeat or, at a minimum, compromise the claims of creditors, stockholders, and consumers injured by products which manifest latent defects.

[33]*See* Sarlitto, *supra* note 27, at 1052 (citing REINSURANCE ASS'N OF AMERICA, LOSS DEVELOPMENT STUDY: 1985 EDITION 5 (1985) (suggesting that as much as 25% of general liability claims to insurers develop over the course of two decades).

[34]*See infra* notes 36-247 (discussing this option).

[35]*See infra* notes 248-420 (discussing this option).

Unfortunately, either alternative poses snares for the unwary manager. Because the deception results from the conceptual blurring of corporate insolvency and dissolution, the following materials expose, in detail, the pitfalls of maintaining a creditor remedy within corporate dogma.

For ease of comprehension, the remainder of Part Three is organized according to statutory and common law alternatives. The detail with which these topics is explored is necessitated by (1) the complexity of the legal issues presented and (2) the author's thesis that the creditor duty (and its historic precedence) should be abolished in favor of contract remedies and actions in common law fraud.

A. *Query: For Purposes of Defining Directorial Duties to Creditors, Will a Corporation with Significant Contingent and Future Unasserted Liabilities be Deemed to be Solvent or Insolvent at the Time of Dissolution?*

Present case law requires a determination of the solvency of a firm at the time of dissolution in order to delineate the parameters of directorial obligations.[36] In particular, if a firm is insolvent at the moment of dissolution, directors are said to owe a duty to creditors.[37] The logical corollary to the insolvency test is that no such duty exists if a corporation is solvent at dissolution.[38]

In the hypothetical, we must determine whether a dissolving firm that has, in the aggregate, liquidated, contingent, and future unasserted claims in excess of corporate assets is insolvent for the purpose of identifying directorial duties to creditors. Specifically, if the existence of contingent and future foreseeable claims render the hypothetical corporation insolvent, the directors owe a fiduciary duty to creditors. In addition, imposition of a directorial obligation to creditors would presumably

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[36]*See, e.g.*, *Geyer*, 621 A.2d at 787 (concluding that the fiduciary duty to creditors arises upon insolvency "in fact"); *Credit Lyonnais*, No. 12,150, 1991 Del. Ch. LEXIS 215, at *108, *reprinted in* 17 DEL. J. CORP. L. at 1155 (articulating a directorial duty to creditors where a corporation is "operating in the vicinity of insolvency").

[37]*Geyer*, 621 A.2d at 787. Of course, the *Credit Lyonnais* opinion extends the duty to creditors to the interval preceding dissolution where the corporation is "operating in the vicinity of insolvency." *Credit Lyonnais*, No. 12,150, 1991 Del. Ch. LEXIS 215, at *108, *reprinted in* 17 DEL. J. CORP. L. at 1155.

[38]The true irony of the "duty to creditors" is that the duty arises at the precise moment at which the corporation, by definition, is unable to pay all creditor claims. Indeed, the duty suggests that *creditors must be paid in full at insolvency*! Yet, if the duty is only that creditors must be paid before equity holders, then the duty is redundant in light of basic principles of contract and commercial law.

compromise, if not preempt, the directors' duties to shareholders. Accordingly, if the duty to creditors attaches, the ability of our hypothetical directors to sell company assets at auction or to declare a dividend is manifestly curtailed.

As applied to the hypothetical, it is clear that the conventional definitions of insolvency[39] fail to give consideration to contingent and future foreseeable claims against a corporation considering dissolution. For example, does the term "liability" encompass claims that, in good faith, are in dispute? Similarly, does the term "liability" include claims that are not in existence at the time of a firm's dissolution (or during the statutory winding-up period post-dissolution), yet are anticipated to arise in the decades which follow the firm's demise? If an affirmative response is given to either of the above questions, then corporations that otherwise consider themselves solvent at dissolution are, instead, insolvent and, thus, under an "obligation" to their creditors.

In *Ray v. Alad Corp.*,[40] a California court held that the California dissolution statute that required compensation of "known debts and liabilities"[41] clearly did not require payment of claims that arose "more than six months after the filing of the dissolution certificate."[42] Similarly, an interpretation of "liability," arguably, should not include "contingent" claims.[43] Although a party may presently assert a contingent claim, the claim is in dispute and, thus, "contingent" as to its success.[44]

Because many failing businesses exit corporate life through bankruptcy proceedings, bankruptcy courts have increasingly sought to

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[39]*See supra* note 6.

[40]560 P.2d 3 (Cal. 1977).

[41]*Id.* at 9 n.5 (emphasis omitted). A "known" claim against a corporation anticipating dissolution includes rights under supplier contracts, mortgage obligations, employee wages, tax obligations, rights pursuant to indemnification agreements, judgements held by tort claimants, and all other claims against the corporation which are in existence and/or identifiable as to claim and claimant at the time of dissolution.

[42]*Id.* at 9. Although the court in *Ray* relied upon a literalist construction of the California statute, another court could reach a contrary conclusion based upon a liberal interpretation of "liabilities."

[43]A "contingent" claim is one which is already asserted or expected to be asserted against the corporation and, thus, is known and identifiable to corporate managers at the time of dissolution. A "contingent" claim, however, is disputed and, therefore, contingent as to its likelihood of success on the merits. Examples of contingent claims include suits in progress regarding breaches of contracts, agreements of indemnification, or claims of negligence by the corporation.

[44]*See* 3 MODEL BUSINESS CORP. ACT § 14.06 (d) (1994) (providing that the term "'claim' does not include a contingent liability or a claim based on an event occurring after the effective date of dissolution").

delineate directorial obligations to creditors under the Bankruptcy Reform Act of 1978 (Bankruptcy Act). The result is that, in bankruptcy actions, insolvency occurs when the sum of a debtor's obligations at fair value exceeds the value of all its property.[45] On the particular issue of the rights of future foreseeable claimants under the Bankruptcy Act, the court in *In re Johns-Manville Corp.*[46] held that future claimants do not hold "claims" in a bankruptcy sense but were instead "parties in interest" who were entitled to appear and be heard in the reorganization of the firm.[47] The court so concluded because (1) some state insurance laws predicated claims liability on *exposure* to asbestos rather than manifestation of injury;[48] and (2) to deny a forum to these "parties in interest" would simply bring the reorganized entity back to the bankruptcy court with each new post-organization asbestos suit.[49]

In 1992, the Delaware Court of Chancery considered the issue of corporate "insolvency" or "insufficiency of funds" under Delaware's recently-enacted dissolution statutes.[50] In particular, the court examined the effect of those terms in determining the rights of contingent and future unknown claimants to the assets of a dissolving corporation.[51] Due to the *RegO* court's attempt to delimit the statutory dissolution rights of existing and future unknown claimants to corporate assets, as well as the significant corporate issues which the case left unresolved, a detailed discussion of the case follows. In particular, the following sections will discuss whether creditors may use *RegO* to impose a directorial duty to

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[45]11 U.S.C. § 101(32)(A) (1994). This definition expressly excludes property subject to a legitimate exemption or property fraudulently conveyed by the debtor within the applicable statutes of limitations. *Id.* Express and contingent liabilities are considered in the bankruptcy process. *In re* Xonics Photochemical, Inc., 841 F.2d 198, 200 (7th Cir. 1988).

[46]36 B.R. 743 (Bankr. S.D.N.Y. 1984). In *Johns-Manville*, the corporation ostensibly filed for reorganization due to a dearth of outstanding and anticipated health-related suits. *Id.* at 744. The court addressed a motion that was brought for the appointment of a legal representative for asbestos-exposed future claimants of Johns-Manville. *Id.*

[47]*Id.* at 757.

[48]*Id.* at 749.

[49]*Id.* at 746; *see also* Gregory A. Bibler, *The Status of Unaccrued Tort Claims in Chapter 11 Bankruptcy Proceedings*, 61 AM. BANKR. L.J. 145, 155-61 (1987) (discussing the concept of contingent claim liability in bankruptcy proceedings). *Cf.* A.H. Robins Co. v. Piccin, 788 F.2d 994 (4th Cir. 1986); *In re* Amatex Corp., 30 B.R. 309 (Bankr. E.D. Pa.), *aff'd*, 37 B.R. 613 (Bankr. E.D. Pa. 1983), *rev'd*, 755 F.2d 1034 (3d Cir. 1985); *In re UNR Indus.*, 29 B.R. 741 (Bankr. N.D. Ill. 1983), *appeal dismissed*, 725 F.2d 1111 (7th Cir. 1984), *motion granted in part, denied in part*, 46 B.R. 671 (Bankr. N.D. Ill. 1985).

[50]*In re* RegO Co., 623 A.2d 92 (Del. Ch. 1992).

[51]*Id.* at 106.

creditors when the corporation has significant contingent and future unasserted claims.

1. *In re RegO Co.* — Examining the Impact of Contingent and Future Foreseeable Claimants on the Duties to Creditors at Dissolution[52]

In re RegO Co. involved the dissolution of a Delaware corporation that had manufactured valves and component parts for liquified petroleum, anhydrous amonia, and other compressed gas systems.[53] Due to the explosive properties of compressed gas, RegO occasionally became involved in lawsuits for property damage or personal injury allegedly caused by the failure of its products.[54]

Until 1987, RegO was insured against such accidents and injuries.[55] In the mid-1980s, however, numerous judgments, resulting in liabilities of several million dollars, caused RegO's insurance premiums to increase significantly.[56] Because of these spiraling costs, RegO terminated its insurance policy and became self-insured in early 1987.[57]

After the company's decision to self-insure, RegO continued to experience large judgments in products liability suits, some of which involved products that had been in service for thirty years.[58] This continuing liability pattern motivated a decision by RegO's stockholder to reorganize RegO's business in order to relieve it of its "claims' legacy."[59] In pursuit of that decision, RegO's stockholder, Marmon Corporation, retained experts to assess the value of the company and to render an actuarial analysis for RegO's potential liability for liquified petroleum products currently in the market.[60] Approximately two months later, the experts reported to RegO an estimated present value of potential

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[52]Various portions of the following section contain direct quotations from the Master's Final Report but are not identified as such because Professor Stilson, as master, authored the Final Report.

[53]*RegO*, 623 A.2d at 98. Liquified petroleum gas is extremely flammable and explosive and causes freezer burns when brought into contact with skin. *See id.*

[54]*Id.*

[55]*Id.*

[56]*Id.*

[57]*RegO*, 623 A.2d at 98.

[58]*Id.*

[59]*Id.* at 98-99.

[60]*Id.* at 99.

products liability claims greatly in excess of RegO's assets.[61] The experts' final report also anticipated claims occurring until the year 2027.[62]

Ostensibly as a result of these reports, as well as its prior claims' history, RegO sold substantially all of its operating assets to a Delaware corporation.[63] Three days after the asset sale, RegO filed a certificate of dissolution with the Delaware Secretary of State.[64] RegO continued to exist as a dissolved corporation under DGCL section 278[65] for the purpose of winding up its business.[66]

RegO's directors elected to wind up corporate affairs pursuant to former DGCL section 280(a).[67] RegO proposed the creation of a claimants' trust that would preserve and distribute to competing claimants all RegO assets that remained as of the effective date of the trust.[68] A *guardian ad litem* (guardian) was appointed by the court of chancery to represent the future products liability claimants.[69] RegO simultaneously petitioned the court of chancery, pursuant to section 280(c), for a determination of the amount and form of security to be provided for these foreseeable, yet unknown, products liability claimants.[70] RegO mailed notice of the section 280 proceeding to all persons and entities known to have pending claims against the company.[71]

As a result of its notice, RegO received widespread responses from potential claimants who sought security from the company for their anticipated claims.[72] These claims fell into one of three categories. The first category represented claims from general creditors of RegO that were paid by RegO in the ordinary course of winding up its affairs.[73]

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[61] *RegO*, 623 A.2d at 99. The final report concluded that the current products liability claims amounted to a present value between $102,697,000 and $115,919,000. *Id.* The best-case estimation of RegO's value amounted to $53-60 million. *Id.*

[62] *Id.*

[63] *Id.* at 99. Throughout the *RegO* proceedings, allegations were made that RegO and the purchasing corporation were related entities. *In re RegO*, No. 11,651, Master's Final Report at 6 n.6. These allegations were not adjudicated in the action before Master Stilson. *Id.*

[64] *RegO*, 623 A.2d at 99.

[65] *See* DEL. CODE ANN. tit. 8, § 278 (1991) (setting forth a three-year winding-up period for a dissolved corporation, subject to extension under appropriate circumstances).

[66] *RegO*, Master's Final Report at 6.

[67] *RegO*, 623 A.2d at 99.

[68] *Id.* at 100-01.

[69] *Id.* at 94.

[70] *See id.* at 102.

[71] *RegO*, 623 A.2d at 99.

[72] *Id.*

[73] *Id.*

The two remaining categories consisted of pending suits against the company or potential products liability actions that might be brought in the future against RegO.[74] The company rejected all claims for security included in the two latter categories.[75]

a. *Payment of Obligations Under the Plan and Trust Agreement*

In pursuit of its decision to wind up corporate affairs under former sections 280 and 281(a), RegO drafted a plan and trust agreement to provide for a "fair, orderly and equitable distribution" of the company's assets to holders both of existing claims and of potential future claims.[76] In an attempt to satisfy this express purpose, a proposed plan of distribution (the Plan) provided that on an effective date,[77] the claimants' trust would be formed to preserve and distribute RegO's assets to the extent provided by the trust agreement.[78] To that end, the trust agreement created six "obligations" categories for which claims could be made against the trust: (1) administrative obligations,[79] (2) pre-existing obligations,[80] (3) contractual obligations,[81] (4) non-product obligations,[82] (5) product obligations,[83] and (6) non-compensatory obligations.[84] The

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[74]*Id.*

[75]*RegO*, 623 A.2d at 99.

[76]*RegO*, Master's Final Report at 8-9 (quoting Preamble to RegO Claimants Trust Agreement).

[77]The claimants' trust became effective on the date the trust was created to implement the proposed plan of distribution.

[78]*RegO*, 623 A.2d at 100.

[79]*Id.* at 101. Administrative obligations included costs and expenses incurred in the administration of the trust and in the litigation of claims brought against, or on behalf of, the trust. *Id.* Administrative expenses were granted priority over all other claims. *Id.* at 101 n.22.

[80]*Id.* at 101. Pre-existing obligations included all claims for amounts incurred prior to the effective date of the trust in connection with the winding up of the affairs of the company and contractual, product, and non-compensatory damage obligations existing, but unpaid, as of the effective date of the trust. *Id.*

[81]*Id.* Contractual obligations were claims which were determined to be properly payable pursuant to the asset purchase agreement executed by RegO or the indemnification provisions of the trust agreement. *Id.*

[82]*RegO*, 623 A.2d at 101. Non-product obligations were those obligations arising from claims other than product claims which were asserted in suits prior to the effective date of the trust and not settled or reduced to judgment until after the settlement date. *Id.*

[83]*Id.* Product obligations included all valid claims arising from settlements or judgments establishing claims for personal injury and property damage caused by products manufactured by the company, including related claims for indemnification or contribution. *Id.*

agreement then set forth a schedule for payment of these obligations that anticipated either payment in full, payment subject to a per occurrence cap, or payment only after all other obligations had been satisfied.[85]

For approximately five years after the establishment of the trust, the trustee[86] was to recommend to the court of chancery whether a date for asserting all product and non-compensatory damage claims should be

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[84]*Id.* Non-compensatory damage obligations included those obligations arising from claims for punitive, exemplary, or other non-compensatory damages which were claimed in connection with a product claim. *Id.*

[85]*Id.* Specifically, the trust agreement allowed for remittance in full for all administrative obligations, pre-existing obligations, and certain contractual obligations as they matured. *Id.* Under proposed modifications to the trust agreement, claims for indemnification determined to be payable under the asset purchase agreement were to be paid subject to an interim limit and payment to the corporation which purchased RegO's assets for indemnification of defense costs were to be subject to the per occurrence limit, with any deficiency to be paid only if funds remained at the termination of the trust. *RegO*, Master's Final Report at 10. In addition, the trust agreement provided that all products liability obligations which were in existence but which had not been paid in full prior to the effective date, were deemed to be pre-existing obligations and thus entitled to be paid in full as they became due. *Id.*

Product obligations, non-product obligations, and non-compensatory damage obligations, except as noted above, which were settled or reduced to a final judgment after the effective date would be paid in full by the trustee up to the per occurrence interim limit. *RegO*, 623 A.2d at 101. Any product obligation covered by insurance would be paid up to the amount of available coverage. *Id.* at 101 n.25. If a product obligation was only partially remitted by insurance, the trust would pay the difference, subject to the interim limit. *Id.* The trustee could seek a modification to the interim limit by the court at any time. *Id.* The trust agreement also required the trustee to conduct a review and make a recommendation to the court at the end of five years of the trust regarding the appropriateness of the interim limit or whether an adjustment should be made to that limit. *Id.* These obligations would be paid for a proven occurrence in the order in which they arose. *Id.* at 101. To the extent two or more obligations relating to a single occurrence arose simultaneously and full payment would exceed the interim limit, payments would be made ratably. *Id.* at 101 n.26. If funds remained at the termination of the trust or the interim limit was thereafter increased, additional payments for partially unpaid obligations would be made up to the amount of the obligations owed or ratably as necessary. *RegO*, Master's Final Report at 11.

[86]The trustee, in exercising his duties under the agreement, could, but was not required to, consult with experts to the extent expert advice was sought. *RegO*, Master's Final Report at 13. The trustee could rely in good faith upon the expert, his information, opinions, reports, or statements if the expert was selected with reasonable care. *Id.* The trustee was also entitled to rely in good faith upon the records of the company and the claimants' trust as well as applicable information provided by trust employees. *Id.*

The trustee was liable for his own gross negligence or willful misconduct but was exempt from giving bond or security in connection with his appointment. *Id.* The trustee was also to be indemnified out of the assets of the trust for all relevant costs, expenses, judgments, fines, or amounts otherwise incurred in connection with the administration of the trust. *Id.* The trustee had a prior lien upon trust assets to secure payment of any amounts owed to him pursuant to the agreement. *Id.*

imposed (the claims assertion date).[87] In the event a claims assertion date was established at that time, or thereafter, as recommended to the court by the trustee, no further product or non-compensatory damage claim could be asserted against the trust if the claim arose after the date imposed.[88] Monies remaining in the trust upon a termination date[89] were to be distributed as follows: (1) ratably for remaining administrative obligations; (2) to the extent funds remained, ratably to the holders of contractual obligations, non-product obligations, and product obligations who did not before receive payment in full; (3) to the extent monies remained, ratably to all holders of non-compensatory damage obligations who did not receive full compensation; and (4) to the extent funds remained, to the sole stockholder of the company as of the effective date.[90]

b. *Interpretative Applications of Sections 280 and 281*

For the first time since the enactment of sections 280 and 281, the Delaware Court of Chancery had to consider the purpose of these sections and apply them to the plan and trust agreement proposed by RegO.[91] In

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[87]*RegO*, 623 A.2d at 102. The trust was to terminate (the termination date) automatically on the date ninety days after the first to occur of the following two events: (1) all product, non-compensatory damage, and non-product claims asserted against the company or trust have been settled or reduced to final judgment and paid as provided in the trust agreement and the claims assertion date has passed; or (2) the trustee has consented to, and the court has approved, the termination of the trust. *Id.*

[88]*Id.*

[89]See *supra* note 87 for a definition of the termination date for the trust.

[90]*Id.*

[91]The Official Commentary to the 1987 amendment of § 280 states:

> New Section 280 creates a procedure that corporations may elect to follow in winding up their affairs, paying claims against the corporate assets and distributing any remaining assets to the stockholders. The section (and Section 281, as amended) is designed to provide a "safe harbor" such that if the procedures described in section 280 are followed and assets are distributed in accordance with Section 281, as amended, directors (or governing persons of a "successor entity" as defined in subsection (d)) will not be held personally liable to unpaid claimants of the corporation for having improperly distributed assets.

66 Del. Laws ch. 136, § 38 (1987).

The Official Commentary to the 1987 amendment of § 281 states:

> Section 281 is substantially new. Subsections (a) and (b) prescribe the procedures for distributing assets, including the distribution of remaining assets to stockholders, of a dissolved corporation which has and has not, respectively, complied with the provisions of Section 280. Subsection (c) deals with the liability of directors (and governing persons of "successor entities") to claimants whose claims against the dissolved corporation are ultimately unsatisfied.

general, the 1990 version of Delaware sections 280 and 281 required a dissolving corporation to provide notice of the impending dissolution to identifiable claimants. These sections also required the dissolving corporation to petition the Delaware Court of Chancery for a determination of the amount and form of security necessary to compensate claims that were not known to the corporation at the time of its demise but that the firm may reasonably have foreseen would arise prior to the expiration of any applicable statute of limitation.[92]

Specifically, section 280 set forth a method for providing notice of a corporation's dissolution to persons having claims against the dissolving entity.[93] Once responses were received from a claimant, the dissolving corporation could reject that claim, in whole or in part, by sending notice of the rejection to the claimant.[94] A similar procedure was set out in section 280(b) which required that the corporation forward notice of the dissolution to persons having contingent, conditional, or unmatured contract claims against the defunct corporation.[95]

The most innovative aspect of the 1990 provisions was section 280(c)(2)[96] which contained sweeping references to future unknown claimants. In particular, section 280(c)(2) required a dissolving corporation that provided notice in accordance with section 280(a) to petition the court of chancery for a determination of

> the amount and form of security which will be reasonably likely to be sufficient to provide compensation for *claims that have not*

Id. § 39.

[92]DEL. CODE ANN. tit. 8, § 280 (1991).

[93]*Id.* § 280(a)(1).

[94]*Id.* § 280(a)(2).

[95]DEL. CODE ANN. tit. 8, § 280(b)(1) (1991). Section 280(b)(1) provides:

> A corporation or successor entity electing to follow the procedures described in subsection (a) of this section shall also give notice of the dissolution of the corporation to persons with contractual claims contingent upon the occurrence or nonoccurrence of future events or otherwise conditional or unmatured, and request that such persons present such claims in accordance with the terms of such notice. Provided however, that as used in this section and in § 281 of this title, the term "contractual claims" shall not include any implied warranty as to any product manufactured, sold, distributed or handled by the dissolved corporation. Such notice shall be in substantially the form, and sent and published in the same manner, as described in subsection (a)(1) of this section.

Id. By this language, § 280(b) targets claims which likely will arise from indemnification agreements. Such claims are necessarily contingent upon the occurrence or nonoccurrence of future events, i.e., the events which will or will not result in liability.

[96]DEL. CODE ANN. tit. 8, § 280(c)(2) (1991).

> *been made known to the corporation or that have not arisen but that, based on facts known to the corporation or successor entity, are likely to arise or to become known to the corporation or successor entity prior to the expiration of applicable statutes of limitation.*[97]

Section 280(c)(2) also permitted the appointment of a *guardian ad litem* to represent the interests of future claimants who, under common law corporate jurisprudence, would lack standing to assert their potential claims during the winding-up process.[98]

A dissolved corporation or successor entity that had pursued the section 280 notice procedure was to pay, or otherwise make provision for, stockholders or claimants as set forth in section 281(a).[99] Section 281(a) specifically required: (1) payment of claims "made and not rejected" under section 280(a); (2) posting of "security offered and not rejected" for contractual claims arising under section 280(b)(2); (3) posting of "security ordered by the Court of Chancery" in any section 280(c) proceeding; and (4) payment of "claims that are mature, known and uncontested or that have been finally determined to be owing by the corporation or such successor entity."[100]

Section 281(a) further mandated that these claims be paid in full "if there are sufficient funds."[101] Conversely, where funds were insufficient, the statute provided that "such claims and obligations shall be paid or provided for according to their priority, and, among claims of equal

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[97] *Id.* § 280(c)(2) (emphasis added). The term "successor entity" is defined in § 280(e) to include

> any trust, receivership or other legal entity governed by the laws of this State to which the remaining assets and liabilities of a dissolved corporation are transferred and which exists solely for the purposes of prosecuting and defending suits, by or against the dissolved corporation, enabling the dissolved corporation to settle and close the business of the dissolved corporation, to dispose of and convey the property of the dissolved corporation, to discharge the liabilities of the dissolved corporation and to distribute to the dissolved corporation's stockholders any remaining assets, *but not for the purpose of continuing the business for which the dissolved corporation was organized.*

DEL. CODE ANN. tit. 8, § 280(e) (1991) (emphasis added).

[98] *Id.* § 280(c)(2).

[99] DEL. CODE ANN. tit. 8, § 281(a) (1991).

[100] *Id.*

[101] *Id.*

priority, ratably to the extent of funds legally available therefor."[102] Any remaining funds were to be distributed to stockholders.[103] Finally, in the absence of actual fraud, the judgment of the directors of a dissolved corporation that had pursued the notice procedures of section 280 was to be conclusive with respect to the provisions made for the payment of mature obligations under section 281(a)(4).[104]

Stockholders of Delaware corporations who received distributions pursuant to sections 281(a) or (b) were not liable for any claim that exceeded the stockholders' pro rata share of the claim or the amount distributed to the stockholders, whichever quantity was less.[105] Stockholder liability was further limited (1) to the extent that claims against the dissolved corporation had to be initiated prior to the expiration of Delaware's three-year survival period[106] and (2) to the amount actually distributed to the stockholders.[107] Similarly, directors of a dissolved corporation, or governing persons of a successor entity, who had complied with the notice procedures of section 281(a) or (b) were not personally liable to claimants of the dissolved firm.[108]

In *RegO*, the guardian and petitioning claimants were at direct odds with the corporation regarding the proper interpretation of sections 280 and 281. According to RegO, these statutes were intended to provide a statutory process for the timely return of corporate assets to the market and a predictable dissolution vehicle for corporate management and

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[102]*Id.* The term "priority" is defined at title 8, section 281(e) of the Delaware Code, as not referring "either to the order of payments set forth in subsection [281](a)(1)-(4) of this section or to the relative times at which any claims mature or are reduced to judgment." *Id.* § 281(e).

[103]DEL. CODE ANN. tit. 8, § 281(a) (1991).

[104]*Id.* Section 281(b), unlike § 281(a), applies to a "dissolved corporation or successor entity which has not followed the procedures described in § 280 of this title." *Id.* § 281(b). As a consequence, any Delaware corporation which elects not to pursue the § 280 notice procedures or to petition the court of chancery for a § 280(c)(2) determination apparently loses the presumption of good faith accorded to certain director decisions under § 281(a) which may result in liability against the firm's directors or stockholders.

[105]*Id.* § 282(a).

[106]*Id.* § 282(b) (referring to the three-year survival interval set forth in title 8, section 278 of the Delaware Code).

[107]DEL. CODE ANN. tit. 8, § 282(c) (1991).

[108]*Id.* This provision is noteworthy in the sense that present dissolution law leaves directors unprotected against future claims of personal liability by unpaid creditors. The legal bases for imposing directorial liability include the trust fund doctrine, fraudulent conveyance statutes, and successor liability. Delaware § 282(c) thus makes clear that directors are not subject to future indefinite liability where those directors comply with the notice procedures of §§ 280 and 281.

stockholders.[109] The guardian and certain claimants suggested a dual purpose. First, these parties argued that the statutes created a discernible and efficient dissolution procedure and incident safe harbor for management and stockholders.[110] Second, the guardian argued that the statutes created potential tort liability for those Delaware corporations that manufacture and place within the public domain products that have a propensity to cause property damage or physical injury to a statistically foreseeable class of plaintiffs for decades after the products' creation.[111]

This initial policy dispute was critical to the resolution of whether RegO's plan and trust agreement complied with sections 280 and 281 inasmuch as the statutes' policies would determine three fundamental premises of RegO's plan.[112] The first of these premises, viewed from RegO's perspective, was that the company was permitted under sections 280 and 281 not to pay all similar claims (including all potential future claims) ratably.[113] The second premise was that RegO was not required to provide security for all potential future claims for whatever period the company was able to predict that these claims might arise (the guardian's self-proclaimed "long view" of these statutes).[114] The final premise was that RegO could impose a per occurrence interim limit on some, but not all, claims against the trust, notwithstanding the identical nature of the underlying causes of action.[115]

RegO posited that the notice requirements of section 280(a) and the distribution directives of section 281(a) compelled a dissolved corporation to pay legitimate claims against the company as they matured during the statutory winding-up period, despite the nature of the claim or the existence of other suits arising from the same or similar occurrences.[116] For example, a products liability claimant who received a judgment during the winding-up process in excess of the value of a dissolved corporation's assets could execute against those assets to the exclusion of similarly situated products liability plaintiffs whose actions were still pending at the time the prior judgment was rendered.[117] Likewise, RegO's interpretation permitted the first judgment creditor to defeat, and

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[109] *RegO*, Master's Final Report at 15.
[110] *Id.*
[111] *Id.* at 15-16.
[112] *Id.* at 16.
[113] *RegO*, Master's Final Report at 16.
[114] *Id.*
[115] *Id.*
[116] *Id.* at 22.
[117] *RegO*, Master's Final Report at 22.

thereby moot the necessity of posting security for, an entire class of foreseeable, future products liability plaintiffs.[118] In addition, RegO suggested that where two or more creditors received judgments during the three-year survival interval[119] (that, in the aggregate, exceeded available assets), section 281 required pro rata payment to those liquidated creditors.[120] RegO concluded that section 281(c) necessitated this result because the company was then "insolvent" and had claims of equal priority which were reflected by judgments against the company.[121]

RegO maintained that these interpretations followed naturally from an application of subsections 281(a)(1)-(4).[122] Simply stated, section 281(a)(4) compelled payment of judgments that arose during the three-year survival period, notwithstanding that such payments might render an otherwise "solvent"[123] corporation "insolvent" and thus one which was unable to post security for future unknown claimants under section 280(c).[124] In addition, RegO emphasized the practical difference between the directive of section 281(a)(4) *to pay mature claims* and the requirement of section 281(a)(3) *to post security* for future unknown claimants.[125] To RegO, the claimants who suggested that RegO's obligation *to post security* suspended its respective duty *to pay* uncontested claims ignored the functional distinction between *posting security* for claims that may never arise and *paying* legitimate, liquidated debts.[126] Finally, RegO rejected any statutory interpretation that required ratable payments in its plan and trust agreement for claims of equal priority because, in its opinion,[127] RegO was solvent at all times before

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[118] *Id.*

[119] *See* DEL. CODE ANN. tit. 8, § 278 (1991).

[120] *RegO*, Master's Final Report at 22.

[121] *Id.* at 22-23. Counsel for RegO concluded that this result was one of the few changes §§ 280-81 made to the prior dissolution laws in Delaware. *See id.* at 23 n.23 (referring to the Delaware Court of Chancery's opinion in Asmussen v. Quaker City Corp., 156 A. 180 (Del. Ch. 1931)).

[122] *Id.* at 23. *See* DEL. CODE ANN. tit. 8, § 281(a)(1)-(4) (1991).

[123] *RegO*, Master's Final Report at 23-24. RegO, therefore, interpreted § 281(a)(4) as addressing *mature* claims only. *Id.* at 24 n.25.

[124] *Id.* at 24.

[125] *Id.*

[126] *Id.* In other words, it was RegO's position that although the company had offered to post all of its assets as security under § 280(c)(2), until its plan and trust agreement were approved by the court, RegO's statutory and fiduciary duties to pay liquidated debts which occurred in the winding-up period were neither extinguished nor suspended. *Id.* at 24 n.26.

[127] *RegO*, Master's Final Report at 24. RegO noted that § 280(c)(2) contained no language which required the company to prioritize or prorate claims. *Id.* at 24 n.27. The statute only required the dissolving corporation to petition the court of chancery regarding the amount and

and during the litigation.[128] RegO defined "solvency" or "sufficient funds" as assets minus *liquidated* liabilities, classifying future unknown claims as irrelevant to a determination of a company's financial status at any particular interval.[129]

The guardian suggested a different interpretation of sections 280 through 282.[130] According to the guardian, RegO dissolved with full knowledge, and for the apparent purpose, of escaping its escalating exposure for products liability actions.[131] As a result, the costs and judgments which, by RegO's own estimates would substantially exceed the company's assets,[132] rendered RegO "insolvent" or with "insufficient funds" for the purpose of section 281(a) and thus required RegO to make payments ratably to holders of claims of equal priority.[133] The guardian apparently interpreted "priority" to entail obligations such as administrative expenses or federal taxes,[134] rather than products liability claims that matured or were reduced to a judgment at varying intervals before or after a corporation's announced dissolution.[135] In other words, the guardian's interpretations ostensibly placed all products liability suits,

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form of security sufficient to provide reasonable compensation to future potential claimants. *Id.* Hence, RegO proposed to transfer all assets to a trust for distribution to legitimate creditors. *Id.*

[128]*Id.* at 24.

[129]*Id.* RegO claimed that Delaware's *primary* purpose in enacting these provisions was to provide a clear and efficient process for the timely return of assets to the capital markets following a corporation's dissolution. *Id.* at 25. RegO conceded, however, that a "competing concern" of the statutes was to avoid "unreasonably depriv[ing] people who have reasonable expectations of being made whole." *Id.* To RegO, these apparently competing concerns could be satisfied by giving effect to § 281(a)'s requirement that dissolved corporations both *pay* mature claims and *post security* for future unknown claimants. *Id.*

In this respect, RegO took issue with the guardian's position that §§ 280 and 281 were intended to protect officers, directors, and stockholders. *Id.* at 25 n.29. Instead, RegO suggested that any protection to these persons was simply a "fall-out of the fact that the protection is necessary in order to have the directors, in particular, give up the assets and send them back into the flow of commerce at whatever the legislatively desirable time is." *Id.*

RegO also argued that Delaware did not *intend* to create rights in future unknown claimants. *Id.* Nevertheless, such a result might *occur* should a board of directors decide to create rights in potential future plaintiffs and then secure a court order to that effect. *Id.*

[130]*Id.* at 25.

[131]*RegO*, Master's Final Report at 25.

[132]*Id.*

[133]*Id.*

[134]*See, e.g.*, *In re* Mitchell's Restaurant, Inc., 67 A.2d 64, 67 (Del. Ch. 1949) (granting priority to the federal government for collection of taxes over claims by the State Unemployment Compensation Commission of Delaware). It is unclear whether the above case remains valid Delaware law after the amendments to § 281.

[135]*RegO*, Master's Final Report at 25-26.

whether pre- or post-effective date and whether liquidated, existing, contingent, or unknown, into one claims' category.[136] This category had to be paid pro rata due to RegO's conceded inability to pay all these claims for whatever foreseeable period they would arise.[137] The guardian justified this resolution on two grounds. First, the explicit language of section 281(e) defined "priority" *not* to include "relative times at which claims mature or are reduced to judgment."[138] Second, the language of section 280(c), for the first time in any jurisdiction, made express reference to obligations owed by dissolved corporations to unknown, yet statistically foreseeable, claims and claimants.[139]

As a corollary to the second justification above, the guardian suggested that section 280(c) compelled RegO to post security for these long-tail claimants for the period in which, by the company's own actuarial analysis, these claims logically could arise.[140] The guardian argued that the legislature intended sections 280 and 281 to create present rights for predictable, future plaintiffs.[141] Once created, the statute required the dissolving corporation "to make adequate provision for" these claimants.[142] The guardian considered the "freedom-of-capital" motivation argument put forth by RegO to be, at best, a secondary purpose for the statutes.[143] Even if such a motivation existed, the guardian argued that it applied only when a corporation had funds sufficient to pay all claims.[144] In this way, the company would be able to set aside monies for all creditors and, thereafter, accelerate the time when distributions could be made to stockholders.[145]

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[136] *Id.* at 26.

[137] *Id.*

[138] *Id.*

[139] *RegoO*, Master's Final Report at 26.

[140] Id.

[141] *Id.*

[142] *Id.*

[143] *RegO*, Master's Final Report at 27.

[144] *Id.*

[145] *Id.* Ironically, implicit in the guardian's argument is the diminishment of the contract and commercial law rights of present, liquidated creditors. The guardian would have these claims prorated, thus creating a subsidy for the future, yet unknown and unascertained, claimants.

c. *The* RegO *Opinions*

The central conflict in the *RegO* case involved the interpretation of section 280(c).[146] The issue, in particular, was whether the trust proposed by RegO provided "sufficient security" for the claims of existing claimants and also provided security which was "reasonably likely to be sufficient" for future unasserted claims.[147]

On this integral issue, the master and the court were in conflict. It was the master's opinion that the "reasonable security" language of section 280(c), as well as the mandate of section 281(b) that a dissolving corporation "make such provision as will be reasonably likely to be sufficient to provide compensation" for unknown claims, did not mandate the posting of security which guaranteed payment in full of all future foreseeable claims.[148]

The court, on the other hand, concluded that because all RegO's assets were concededly insufficient to "reasonably assure the payment of all foreseeable[,] future claims," the RegO trust was inadequate to offer the "full security" required by section 280(c).[149] The court nevertheless acknowledged that where a dissolving corporation transfers all of its assets to an entity dedicated to the preservation and distribution of those assets, the "inadequacy of those assets to offer full security ought not to deprive the directors of the corporation from proceeding" under the safe harbor procedures of sections 280 and 281(a).[150] In other words, if corporate assets are inadequate to secure full compensation to all future foreseeable claimants, the sufficiency of a proposed security arrangement will be determined by the "fairness" of the arrangement.[151] In the case of the RegO plan and trust, the court concluded that any plan that accorded full payment to existing creditors but that, at least initially, capped compensation to future claimants at an interim limit, was inappropriate.[152] The court based its ruling upon its conclusion that sections 280 through

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[146]*RegO*, 623 A.2d at 102. *See* DEL. CODE ANN. tit. 8, § 280(c) (1991).

[147]DEL. CODE ANN. tit. 8, § 280(c)(2) (1991).

[148]*RegO*, Master's Final Report at 33-34.

[149]*RegO*, 623 A.2d at 102.

[150]*Id.*

[151]*See id.*

[152]*Id.* at 107-08.

282 created present rights in future plaintiffs — rights that were co-extensive with those of existing claimants.[153]

2. Observations and Commentary on the Delaware Enactments

For the most part, the Delaware enactments must be viewed as an innovative and perceptive attempt to apportion claimant risks and director liability. In the market test of Delaware's efforts (i.e., the *RegO* case), however, the legislation reveals several deficiencies. Those deficiencies may be categorized as substantive, procedural, and theoretical.

a. *Substantive Concerns*

1. Do the Statutes Create Present Rights in Contingent and Future Unknown Claimants and Thereby Impose a Directorial Duty to These Claimants?

The essence of the *RegO* action was section 280(c).[154] Section 280(c)(2) required a dissolving corporation to petition the court of chancery for a determination of "the amount and form of security which [would] be reasonably likely to be sufficient" to compensate unknown, yet foreseeable, "claims."[155] Section 281(a) thereafter required that where funds were "insufficient" to pay all claims in full, such "claims and obligations" were to be paid or provided for according to their priority and, among claims of equal priority, ratably.[156]

According to the court, RegO had insufficient funds to assure full compensation for all future foreseeable claims.[157] Section 281(a), therefore, obligated RegO to prioritize and prorate the appropriate claims

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[153]*RegO*, 623 A.2d at 106. Ironically, however, the court's interpretation does not reallocate assets between present and future claimants but rather strips assets from existing creditors in defiance of extant contract and commercial law principles.

[154]DEL. CODE ANN. tit. 8, § 280(c) (1991).

[155]The pertinent language of § 280(c)(2) states:

> A corporation or successor entity which has given notice in accordance with subsection (a) of this section shall petition the Court of Chancery to determine the amount and form of security which will be reasonably likely to be sufficient to provide compensation *for claims that have not been made known to the corporation or that have not arisen but that, based on facts known to the corporation or successor entity, are likely to arise or to become known to the corporation or successor entity prior to the expiration of applicable statutes of limitation.*

Id. § 280(c)(2) (emphasis added).

[156]*Id.* § 281(a).

[157]*RegO*, 623 A.2d at 102.

against the company, subject to the court's scrutiny of the fairness of the company's proposed security arrangement.[158] The master, however, submitted that the terms "claims," "obligations," and "insufficient funds," as used in sections 280 and 281, did not envision security of full payment of all future assertions of liability which are, by definition, inchoate and in existence solely in actuarial analyses.[159]

In 1994, the Delaware Legislature amended sections 280 and 281 to align more closely with the master's interpretation in *RegO*. For example, in 1994, a dissolving corporation may pay current claims without regard to the prorating of those claims against future unasserted claims.[160] In addition, existing claimants who receive notice of a firm's dissolution will be prohibited from bringing suit if their claim is not presented to the corporation within 60 days[161] of the notice or if they fail to initiate suit within 120 days after their claim is rejected by the corporation.[162] Further, after the 1994 amendments, directors who pursue a judicially-supervised dissolution must only make reasonable provision for (1) pending litigation claims,[163] and (2) claims that are likely to become known to the corporation within five to ten years of the date of dissolution.[164]

Unfortunately, the 1994 amendments to sections 280 and 281 do not alter the court's interpretation in *RegO* which, rather than reallocating assets among claimants, divested assets from existing creditors in disregard of contract and commercial law principles. In other words, the statutes remain unclear in their balance of existing claimants' present commercial and contract law rights with the disputed and contingent rights of pending and future foreseeable claimants. Consequently, an opening query is whether the reference in newly-amended section 280 to "claims" and in section 281 to "claims," "obligations," and "insufficient funds"[165] includes contingent and future unknown claims such that a

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[158] *Id.* at 102-03.

[159] RegO, Master's Final Report at 33-34.

[160] DEL. CODE ANN. tit. 8, § 280(a)(1) (1994).

[161] The statute mandates that this 60-day period is the *minimum* amount of time that a corporation can require notice of a potential claim. *Id.* § 280(a)(1)(c).

[162] *Id.* § 280(a)(4).

[163] *Id.* § 280(c)(1).

[164] DEL. CODE ANN. tit. 8, § 280(c)(3) (1994). The amendments deleted all references to "applicable statutes of limitation" and an ostensible limitations period of five to ten years from the date of dissolution, according to the court's discretion, was substituted in its place. A similar limitations period was added for extrajudicial dissolutions. *See* 69 Del. Laws ch. 266, §§ 15, 20 (1994).

[165] *See* DEL. CODE ANN. tit. 8, § 281(a)(1)-(4) (1994).

corporation — for the purpose of defining directorial duties to creditors — may be deemed insolvent by analogy to the Delaware dissolution statutes.

For example, is a corporation that pursues judicial dissolution under section 280 (or an extra-judicial dissolution under section 281(b)) and that has contingent and future unknown claims, solvent or insolvent at the moment of, or the interval approaching, dissolution? If the Delaware dissolution statutes are applied by analogy to conclude that the corporation is insolvent, then the directors are subject to more stringent judicial scrutiny than if the corporation dissolved while solvent. Directors of the corporation likewise are severely constrained in their ability to exercise discretionary decision making. Accordingly, a determination of firm solvency or insolvency is essential for directors who contemplate a sale of corporate assets, the payment of dividends, or the settlement of pending claims prior to dissolution.

Resolution of this query is not merely academic. If the *RegO* opinion remains viable after the 1994 amendments and the terms "claims" and "obligations" under Delaware's 1994 revisions include *contingent*, as well as *provable or probable* claims, then innumerable corporations have "insufficient funds" with which to pay creditors. Thus, an accurate and practical determination of the intended interpretation of the 1994 modifications is critical to directors who must devise and implement a complex corporate dissolution.

For example, consider the hypothetical corporation that is formed for the purpose of developing and marketing a safe method for the transportation and disposal of radioactive waste. Under virtually all state corporate statutes, the original entity is permitted to incorporate with little or no initial capitalization.[166] Stock may thereafter be issued to the founders for no par, low par, or nominal par.[167] The obvious design of the incorporation of the venture is to limit the liability of the founders to

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[166]*See, e.g.*, DEL. CODE ANN. tit. 8, § 102(a) (1991) (setting forth the required provisions of a Delaware Certificate of Incorporation); *id.* § 106 (defining the moment of corporate existence as the filing of the certificate of incorporation with the Secretary of State). *See also* 1 MODEL BUSINESS CORP. ACT §§ 2.02-.03 (1994) (containing analogous provisions).

[167]The concept of par originally was devised to create a safe balance sheet for creditors who chose to conduct business with a corporation. HAMILTON, *supra* note 14, at 308. Consequently, statutory provisions relating to par necessarily included provisions on stated capital, restrictions on the payment of dividends, share repurchases or other corporate transactions which directly or indirectly involved a distribution of firm assets which otherwise would be available for the payment of creditor claims. Today the historic use for par has largely been abandoned in favor of contract protection for creditors who do business with corporate entities.

the initial corporate capitalization or any assets purchased with these funds. The combined lack of statutory capitalization requirements and the permissible issuance of stock for nominal legal consideration permit the new corporate enterprise and its owners to undertake an exceptionally hazardous business with little or no capital against which any legitimate claims can be satisfied.[168] In this manner, state corporate law has effectively *encouraged* founders to engage in legitimate risk-allocation for the new business by promising risk-transference of foreseeable liabilities to those whom the corporation may harm through tort or contract.

Assume that the hypothetical corporation's directors elect to incorporate under Delaware law. The founders provide minimal initial capital and sell founding stock to themselves for an inappreciable amount. The corporation thereafter develops a process for the transportation and storage of radioactive waste that it sells to a buyer. Assume further that a failure of the process to perform as expected results in astounding personal injury and property damage. The company's future foreseeable liabilities are not easily calculated because radioactive materials have differing half-lives, divergent potentials for harm, and disputed latency periods for manifestation of injuries. If a buyer implements the developing corporation's process *in toto* and a disaster occurs, the question becomes whether the selling corporation is liable for contingent, predictable, and statistically possible damages that have occurred, or will occur, as a direct result of the failed performance of the seller's process. If the selling corporation is found to be liable under the *RegO* opinion, the question becomes whether the firm's directors may opt to dissolve the business under sections 280 through 282 with the singular intention of escaping these, as well as other, claims arising from the same accident.[169]

Under the 1994 amendments, it appears that the corporation may elect to dissolve either under section 280 (judicially-supervised dissolution)[170] or section 281 (extrajudicial dissolution).[171] Either option requires the

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[168]As a practical matter, of course, the firm must obtain seed capital in order to undertake required research. This initial capital may be raised, however, through loans or the sale of debt securities. For purposes of this hypothetical, assume that no other regulations (e.g., environmental regulations) govern the conduct of the parties.

[169]Of course, under the hypothetical as posited, the corporation may well choose not to dissolve because any judgment against the corporation will go unsatisfied.

The hypothetical raises another related question. If the directors elect dissolution pursuant to §§ 280-282, are their judgments pre- and post-dissolution protected by a presumption of good faith and non-liability or are their decisions subject to the court's strict scrutiny of the entire fairness of those judgments?

[170]DEL. CODE ANN. tit. 8, § 280(a), (c) (1994).

[171]*Id.* § 281(b).

dissolving corporation to make reasonable provisions for pending actions[172] as well as for claims that are likely to arise within five to ten years post-dissolution.[173] Section 281 thereafter mandates the *payment* of "mature, known and uncontested" claims,[174] the *posting of security* for pending and future unasserted claims,[175] or the making of reasonable provisions for pending and future unknown claims.[176] If the 1994 revisions, by requiring security or provisions for contingent and future unasserted claims, deem our hypothetical corporation to have "insufficient funds" to pay all claims,[177] then the corporation arguably has assumed greater risk at dissolution than at incorporation.[178]

Under the modified language of section 280(c), the corporation has pending claims and can foresee claims that have not arisen but that may arise or become known to the corporation within ten years of the date of dissolution[179] Therefore, our hypothetical corporation has three apparent choices. First, the corporation could defend the suits, win, finance the costs of litigation, and continue the pursuit of its stated business goals. Second, the directors could elect to concede liability, permit all known and contingent claimants to litigate among themselves for rights in the firm's assets, put any judgment creditors to the task of locating corporate assets upon which to execute,[180] and, thereafter, informally terminate all business involving radioactive waste disposal research. Finally, the corporation could defend the suits, lose, and dissolve the corporation under sections 280 and 281 with the intent of legally terminating the enterprise and granting a safeguard from future liability for the firm's founders and directors.

Under the third option, the dissolved corporation's assets are, "in total[,] inadequate to secure full compensation to all foreseeable future

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[172]*Id.* §§ 280(c)(1), 281(b)(ii).

[173]*Id.* §§ 280(c)(3), 281(b)(iii).

[174]DEL. CODE ANN. tit. 8, § 281(a)(4) (1994).

[175]*Id.* § 281(a)(2)-(3).

[176]*Id.* § 281(b)(ii)-(iii).

[177]Under this scenario, "insufficient funds" existed because the existing, contingent, and future foreseeable claims — in the aggregate — exceeded corporate assets.

[178]Under the 1994 amendments, if the hypothetical corporation elected to dissolve under §§ 280-282, it would be considered to have insufficient funds with which to pay its "claimants," not to mention any employee wages, federal or state taxes, rent, and/or overhead that may be due.

[179]*See id.* § 280(c)(1)-(3).

[180]Of course, the irony of this alternative is that the first one or more judgment creditors who locate firm assets and execute upon same will utterly deplete the corporate estate — effectively defeating all later judgment or contingent creditors or future unknown claimants.

claimants."[181] Management's proposed plan of distribution, therefore, will be subject to the court's determination of fairness, as guided by the policies reflected in the Delaware enactments.

This result seems antithetical to basic corporate jurisprudence which permits, indeed invites, risk-shifting by investors through the mere act of incorporation.[182] For example, assume a research scientist develops a cure for AIDS and, thereafter, forms a corporation for the purpose of producing and marketing the cure. After five years in operation, the curative drug is so successful that AIDS is eradicated and the scientist is a millionaire. Finally, assume that the market for the drug has evaporated due to the disappearance of AIDS. Scientific evidence, however, indicates a nominal likelihood of birth defects in the children born to a small percentage of those treated with the drug. Because the market for the drug no longer exists, the scientist elects to liquidate the business and distribute the remaining monies to herself. In light of the future foreseeable injuries, what dissolution obligations are imposed on the scientist when she elects to liquidate the firm? In particular, may she dissolve under section 280 and, thereafter, distribute income to herself? If not, must she freeze some portion of her earnings for possible payment to future claimants?

On the one hand, the obvious attraction of the corporate form is the transferral of internal and external market risks from the owner/managers to those who elect to conduct business with a corporate entity. To compel greater security for future contract or tort claims — which exist only in actuarial analyses — flies in the face of basic precepts of corporate law.

On the other hand, two points must be weighed if the thrust of the 1994 revisions is that, in equity, certain types of suits (mass products liability claims) against certain categories of corporations (publicly-held enterprises) should receive enhanced guarantees upon a corporate defendant's dissolution. First, current corporate philosophy considers a corporation to be an independent juridical person.[183] The imposition of higher financial burdens at firm dissolution or insolvency, therefore, becomes anomalous to the entity theory of corporate governance. Second, retrospective equity findings by a reviewing court pose planning nightmares for corporate directors who must guide a financially unstable firm through its legal demise.

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[181] *RegO*, 623 A.2d at 102.

[182] *See supra* notes 166-68 and accompanying text.

[183] Note, *supra* note 9, at 1641.

Under the first point, if a natural person placed toxic chemicals into a public water supply, one may easily predict property damage and personal injury to occur for decades after the individual's misconduct. If the claimants obtained judgments against the defendant, those judgments would represent only the right of the successful plaintiffs to locate assets upon which to execute. If the individual defendant lacked sufficient assets to pay the judgments, the creditors would be without recourse for the amounts that remained unpaid. Further, if the wrongdoer was judgment-proof or was immediately diagnosed with a terminal illness, no principle of American law commands the tortfeasor to fund a trust with present assets or life insurance proceeds to compensate these, as well as all statistically foreseeable, plaintiffs.

If Delaware's 1994 version of sections 280 and 281 seek to interject the societal directive that *corporate persons* be held to a higher standard where contingent claimants and actuarially-possible tort and contract victims may be compromised ten years after the corporation's demise, the statutes require further amendment. One must assume, however, that if the legislature intended such an interpretation, or seeks such an amendment, numerous Delaware corporations will pursue a secure dissolution haven elsewhere. In addition, one must speculate that corporations that remain in Delaware will discover, through creative counsel, alternative dissolution techniques that are not as financially burdensome and that do not subject the directors to personal liability after dissolution.[184] Either result obviously circumvents the utility of the revised Delaware statutes.

On the second point, if the hypothetical corporation chooses to dissolve pursuant to amended sections 280 and 281 and the court of chancery determines that the company has "insufficient funds," section 281 requires that corporation to pay all existing and future claims according to their priority and, among claims of equal priority, ratably.[185] In the hypothetical, therefore, the dissolving corporation must undertake an actuarial analysis of statistically possible claims that must thereafter be prorated against contingent claims.

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[184]Of course, one basic assumption in the above hypothetical is that if the corporation has insufficient funds with which to pay these claimants, then no distributions would be made to stockholders or directors in derogation of creditor rights. If, however, the corporation were to precede its dissolution with a transfer of all corporate assets to stockholders in anticipation of the impending lawsuits, basic principles of fraud would compel the return of those assets to the corporation for distribution to legitimate claimants.

[185]DEL. CODE ANN. tit. 8, § 281(b) (1994).

In *RegO*, the dissolving company predicted that the imposition of an interim cap on products liability claims would render full payment of ninety to ninety-five percent of all claims within a few years after the corporation's dissolution.[186] Several creditors of RegO disputed the company's interim limit and recommended substitute caps or hypothetical prorating figures.[187] Interestingly, though, no party to the *RegO* litigation seriously maintained that the cap should be abandoned for failure to prorate the creditor interests as required under section 281. In essence, therefore, it seems the *RegO* claimants sought only the right to second-guess management as to an appropriate interim limit. The claimants did not seek the displacement of that limit because the limit represented a fair attempt by the corporation to provide full compensation to present claimants and almost total payment to future claimants. The court, in its "fairness" ruling, however, concluded that a plan that preferred present claimants over unknown or future claimants did not meet the statutory requirements.[188]

The planning impediment which is presented by the court's "fairness" test is that once a corporation is found to have "insufficient funds," section 281's mandate of prorating is invoked. As a consequence, under the plain language of sections 280 and 281, directors would logically presume that a judicial finding of an insufficiency of corporate assets under section 280 necessarily requires judicial imposition of prorating. Yet, in *RegO*, the court simultaneously *found the corporation to have "insufficient funds"* to pay all claims, *adopted* the company's concept of an interim limit, and with the vision of judicial hindsight, *modified* the dollar cap.[189] To the court, this result was "fair" under the circumstances of the case.[190]

Yet, if corporations are to utilize sections 280 through 282 as director and creditor safe harbors, then some degree of prospective certainty and management protection must be evident. From a planning perspective, therefore, *post hoc* fairness determinations result in retrospective judicial determinations of directorial mistakes — liability which directors can ill afford. As a result, in the absence of judicial deference to directorial decisions and management presumptions of good faith and non-liability,

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[186]*See RegO*, 623 A.2d at 110. The claims which would not be paid were those which became manifest after the termination of the trust. *Id.*

[187]*Id.* at 109.

[188]*Id.* at 106.

[189]*Id.* at 110.

[190]*RegO*, 623 A.2d at 105.

corporate directors likely will ignore sections 280 through 282 and, instead, pursue predictable techniques for corporate termination.

Further, in her report, the master noted the realistic obstacle of imposing a duty on a dissolved corporation to marshall non-existent assets for the purpose of providing future insurance to contingent and statistically predictable plaintiffs. Specifically, Master Stilson referred to the failure of section 280 to stay all creditor actions against a financially unstable enterprise.[191] The practical consequence of failing to stay these actions is the *ability* and *right* of judgment creditors to defeat the section 280 rights of contingent or future foreseeable claimants. In the absence of such a stay, it seems that sections 280 through 282 do not empower a Delaware court to curtail or compromise the legitimate commercial law rights of liquidated creditors for the benefit of statistically possible claimants.

Instead, the master suggested that the Delaware amendments were intended to set forth a *notice procedure* for dissolving corporations. Through this procedure, a complying corporation may accelerate its duties to all known and reasonably foreseeable future claimants, placing limits on future liability for distributions by management to stockholders or directors. This notice procedure, however, should not entitle contingent or long-tail claimants to security for full payment of their claims for up to ten years post-dissolution. Rather, the notice procedure should simply close the previous gap in corporate law that afforded no mechanism for corporate directors and stockholders to dissolve and wind up the enterprise without indefinitely fearing accountability to succeeding plaintiffs. Further, implementation of a notice process within a corporate dissolution statute would permit, for the first time, the appointment of a *guardian ad litem* to represent the interests of prospective plaintiffs.

In sum, a "notice interpretation" of sections 280 through 282 aligns more readily with commercial reality than one that creates present rights in contingent and unknown, statistically foreseeable, plaintiffs. The reasons are threefold. First, the Delaware enactments impose no automatic stay analogous to section 362 of the Bankruptcy Reform Act of 1978.[192] Such a stay would be necessary to preserve corporate assets for future distributions to delay-occurrence plaintiffs. Second, current corporate philosophy considers a corporation to be a juridical person, independent from its owners. The corporation, therefore, is independently liable for its contract and tort obligations. Finally, the imposition of a more exacting duty upon directors at firm dissolution would have at least

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[191] *RegO*, Master's Final Report at 32-33.

[192] 11 U.S.C. § 362 (1988 & Supp. 1994).

two deleterious consequences. One, the enhanced duty would dissuade corporate management from notifying creditors of the financial status of the business (and the impending legal termination of same through dissolution). Two, this higher duty would encourage corporate directors to relegate present and future creditors to their common, contract, or commercial law privileges. These rights, by necessity, would be pursued against the business after its financial, if not legal, death. Stated differently, creditors would pursue these claims after the period in which they could have sought a hearing under section 280 or could have attempted a stay of sales or transfers of corporate assets.

A few final thoughts: if the 1994 amendments or the *RegO* opinion intimate that creditor payment protections vest only upon *dissolution*, directors must question whether these statutory duties may be circumvented by the full payment of all creditor debts as they come due, until the moment at which all corporate assets are dissipated. On the other hand, if the *RegO* opinion proposes that directors have a corporate *fiduciary duty to creditors to dissolve the firm* and, thereafter, to comply with the distribution procedures of section 281, one must question at what moment this duty arises. Additionally, courts must determine what precept of corporate law justifies creation of this "duty to dissolve." Finally, this interpretation of *RegO* will require the courts to consider the relationship of this duty to the historic directorial duties to stockholders that arise under the traditional fiduciary paradigm of corporate governance.[193]

2. What is the Effect of the Legislature's Imposition of a Ten Year Bar Date on Future Foreseeable Claims?

In *RegO*, the guardian posited that section 280(c) compelled a dissolving Delaware corporation to post security for long-tail products liability claimants for whatever time period the dissolved firm, by its own actuarial analysis, could anticipate the claims would arise.[194] In *RegO*, those claims were predicted to continue for thirty-six to forty-four years after the company's dissolution.[195] The basis for the guardian's "long-view" of section 280 was the statutory directive that a corporation provide sufficient security for claims that have not arisen but that, based upon

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[193]For a discussion of the theoretical issues concerning directorial duties to creditors which *RegO* left unanswered, see *infra* notes 234-35 and accompanying text.

[194]*See* Transcript of Hearing at 75-77, *In re* RegO (Hearing Before the Master *Pro Hac Vice*, Feb. 14, 1992).

[195]*Id.* at 76.

facts known to the corporation, are likely to arise before applicable statutes of limitation expire.[196] According to the guardian, section 280 required RegO to make adequate provision for future foreseeable claimants, recognizing that those individuals represented a class of imminent creditors who lacked a present remedy for their anticipated injuries.[197]

In 1994, sections 280 and 281 were amended to limit the guardian's interpretation of "applicable statutes of limitation." Specifically, the statutes now require a plan of liquidation to

> make such provision as will be reasonably likely to be sufficient to provide compensation for claims that have not been made known to the corporation or that have not arisen but that, based on facts known to the corporation . . ., are likely to arise or to become known . . . *within 10 years after the date of dissolution.*[198]

The 1994 amendments have statutorily imposed a ten-year bar date for the assertion of future foreseeable claims.[199] One difficulty with such a date is its seeming arbitrariness. Recognizing that any bar date suffers from the same infirmity, a second point requires observation: statutory imposition of a limitations period is subject to equity tolling in appropriate circumstances.[200] For example, if the Delaware Legislature intended to provide certainty for judicial dissolutions pursuant to sections 280 through 282, then substantial progress has been achieved with the deletion of "applicable statutes of limitation" in favor of a ten-year limitations period. Unfortunately, the arbitrariness of the selected interval and the fact that such an interval is subject to equity tolling will permit claimants to litigate the equity considerations and potentially to modify this interval. The obvious disadvantage of equity tolling as applied to the

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[196] *Id.* at 75; *see* DEL. CODE ANN. tit. 8, § 280(c)(2) (1991).

[197] Transcript of Hearing at 73-74, *In re* RegO (Hearing Before the Master *Pro Hac Vice*, Feb. 14, 1992).

[198] DEL. CODE ANN. tit. 8, § 281(b)(iii) (1994) (emphasis added); *see also id.* § 280(c)(3) (limiting the court of chancery's ability to extend the period for which security is required).

[199] DEL. CODE ANN. tit. 8, § 281(b)(iii) (1994) (emphasis added); *see also id.* § 280(c)(3) (limiting the court of chancery's ability to extend the period for which security is required).

[200] *See, e.g.*, Halpern v. Barran, 313 A.2d 139, 143 (Del. Ch. 1973) (tolling a statute of limitations because of fraudulent concealment). *See also* 3 MODEL BUSINESS CORP. ACT § 14.07 (1994) (imposing a five-year limitations period). *See also infra* notes 306-29 and accompanying text (discussing the distinction between a survival or limitation dissolution statute).

ten-year bar date is its crippling effect on managers who must devise a fair plan of liquidation based upon facts known at the time of dissolution.

An alternative to a statutory limitations period is the judicial imposition of a post-dissolution "claims assertion date." Such a date would be ascertained after judicial consideration of the nature of the firm's anticipated liabilities and examination of the statutes of limitations in the jurisdictions in which such claims would likely arise. A claims assertion date alternative permits the efficient redeployment of capital to the market in a reasonable time post-dissolution, yet curtails legitimate tort and contract claims that arise subsequent to the bar date. For example, in the hypothetical, if a claims assertion date is judicially imposed after notice to parties in interest and a subsequent hearing, firm assets will be placed within the capital markets at a specific, reasonable time after dissolution. This method would provide certainty and predictability of distributions to creditors who hold claims against the defunct entity by barring litigation of those claims that arise subsequent to the claims assertion date. Moreover, because the "equities" of the case previously were resolved,[201] the claims assertion date ostensibly would prevent the appointment of a receiver to undertake such litigation. Accordingly, this option judicially balances the privileges of known and existing claimants as against future unknown plaintiffs.

Conversely, the option adopted by the 1994 amendments provides a bright line for purposes of directorial planning. Its disadvantage is the retention of uncertainty due to retroactive applications of equity principles for determinations of tolling. For instance, if the same corporation were to dissolve pursuant to section 14.07 of the Model Business Corporation Act (MBCA) (which imposes a five-year bar date for future unknown claims), directors may purchase insurance to cover those injuries that may arise in the five-year post-dissolution interval. Once this insurance is purchased, the directors may distribute the remaining corporate assets to present creditors or stockholders. Claimants who are injured after the five-year limitations period arguably are without a remedy in light of the statutory termination date. Nevertheless, MBCA-like legislation generally is considered to impose a statute of limitation and, therefore, is subject to equitable tolling in suitable circumstances.[202] The ability of

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[201]This alternative contemplates the continued provision in § 280(c)(2) for the appointment of a *guardian ad litem* to represent the interests of future foreseeable claimants.

[202]*See infra* notes 306-29 and accompanying text (discussing the differences between survival and limitation dissolution statutes). Appropriate circumstances for equitable tolling may include material after-discovered evidence, recent scientific discoveries or techniques for discovery, or the difficulty of predicting future injuries due to the unique nature of the accident

prospective creditors to stay, modify, or annul dissolution arrangements after the statutory bar date arguably undercuts the apparent benefit to statutorily-imposed termination times for unknown claims.

It is suggested that the Delaware enactments cannot realistically provide the anticipated market incentive for notice dissolutions unless the alternative option is considered. The recommended amendment should create judicially-imposed bar dates that are established after consideration of all factors pertinent to the case at hand.

Thus, in the hypothetical corporation, if future claims are those that result from radioactive poisoning to persons and property, a reviewing court would examine scientific evidence as to the half-life of the waste that caused the poisoning, the nature of future injuries (e.g., whether radioactive injuries to property differ from those to persons), the likelihood that the original poisoning will result in second-generation injuries (e.g., birth defects manifest in the offspring of the original victims), the jurisdictions in which these injuries will likely occur, and the applicable statutes of limitation in those jurisdictions. The court would also consider the nature of pending claims against the firm and the ranges of judgments sought by the plaintiffs to those actions. Once the factors underlying the pending and future unasserted claims are identified, the reviewing court would weigh this information to calculate what would constitute "sufficient security" under section 280 and to determine the assertion date after which all claims would be barred.

This alternative appears superior to the present legislation for two reasons. First, the court of chancery currently must determine the sufficiency of provisions for pending claims, as well as for future unasserted claims.[203] In the hypothetical, the court would have to determine what amount is "sufficient" for the five pending personal injury suits. On this question, two possibilities arise. The first possibility would require security in the amount of the plaintiff's *ad damnum*. The second option would require directors to post security in an amount equal to the directors' good faith valuation of the claim. The second alternative, unlike the first, retains the corporate principle that directors — not claimants — manage the firm.[204]

Such a solution also furnishes a reasonable degree of predictability for directors in the sense that management may, prior to dissolution, engage in an economic analysis. This analysis would weigh the benefit of preserving corporate assets for legitimate future claimants against the

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which caused the injuries.

[203]DEL. CODE ANN. tit. 8, § 280(c)(1), (3) (1994).

[204]*See* DEL. CODE ANN. tit. 8, § 141(a) (1991).

desirability of placing corporate assets back within the capital markets for productive use. If corporate management concludes that the payment of pending and future claims outweighs the need for present reimbursement to existing creditors, its plan of distribution and proposed claims assertion date will reflect this decision. Party litigants and the *guardian ad litem* likewise would be able to undertake a similar economic analysis for the court's consideration. In this manner, a reviewing court would consider (1) the nature of contingent and future claims, (2) the number and amount of existing claims, (3) the necessity for further maintenance of a trust or other successor device in favor of contingent and future foreseeable plaintiffs, (4) the interests of current creditors who have expended funds to litigate their rights and who have yet to secure a judgment for those claims, and (5) the costs of creating and administering a successor trust for at least ten years after a firm's dissolution.[205]

Such an amendment would have the obvious disadvantage of imposing upon a dissolving corporation, party litigants, the *guardian ad litem*, and the reviewing court, the significant costs associated with devising a fair claims assertion date. Certainly, if the Delaware enactments are to achieve their market goal, they should minimize the legal expenditures and litigation costs associated with the dissolution process itself. Despite the potential for these costs in the proposed amendments, it is suggested that this refinement to the Delaware statutes provides (1) greater economic certainty for directors (and, hence, an enhanced desire to utilize the Delaware notice procedures); (2) greater potential for preservation of corporate assets for future distributions to creditors and stockholders; and (3) less potential for retroactive equity tolling. Indeed, section 280 presently anticipates some degree of judicial cognizance of pending and future claims. The proposed refinements to the statute simply define the scope of that judicial examination and result in greater predictability for corporate managers and claimants and lower costs for the dissolving firm. The proposals also provide the checks and

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[205]The costs of maintaining a successor entity include compensation for the trustee, employee wages, litigation costs, attorneys' fees, and charges on supervising investment assets. In *RegO*, if the parties in interest had litigated the company's plan of distribution until each creditor was satisfied, attorneys' fees alone would have depreciated the company's estate to a point that no assets would have remained for distribution to creditors. This problem of litigating all aspects of a corporate or natural person's reorganization or liquidation is presently under consideration by the bankruptcy courts. Clearly one difficulty in the federal and state insolvency process is that attorneys, and other experts necessary to the litigation, receive a priority in payment with the result that lengthy litigation completely depletes a debtor's estate to the detriment of those whom the attorneys represent.

balances necessary to alleviate directorial tension between future claimants and deployment of assets.

3. Do the Statutes Intend to Create Temporal Parity Among All Existing, Contingent and Future Unknown Claimants?

In *RegO*, the court of chancery concluded that the portions of the company's plan and trust agreement that accorded full payment to pre-existing obligations[206] arising during the winding-up period were "not justified" within the factual parameters of the case.[207] As such, the court held that RegO's proposed plan of distribution failed to satisfy the security requirements of section 280(c)(2).[208]

Former section 280(c)(2) compelled a dissolving corporation to petition the court of chancery for a determination of "the amount and form of security which [would] be reasonably likely to be sufficient to provide compensation for" future unknown claimants.[209] Section 280(c)(2) also permitted the appointment of a *guardian ad litem* to represent the interests of the potential future plaintiffs.[210]

A dissolved corporation or successor entity that had pursued the section 280 notice procedure was to pay, or otherwise make provision for, stockholders or claimants as set forth in section 281(a).[211] Section 281(a) also mandated that these claims be paid in full if funds were sufficient to compensate all claims.[212] Conversely, where funds were insufficient, "such claims and obligations [were to] be paid or provided for according to their priority and, among claims of equal priority, ratably."[213]

In the 1994 amendments to sections 280 and 281, the prorating of present, contingent, and future claims as required in *RegO* was apparently abandoned. For instance, revised section 280(a)(1) states that present claimants who receive actual notice of a pending dissolution will be barred from suit if a claim is not presented to the dissolving corporation

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[206]*See supra* note 80 for a definition of pre-existing obligations.

[207]*RegO*, 623 A.2d at 103.

[208]*Id.* at 106.

[209]DEL. CODE ANN. tit. 8, § 280(c)(2) (1991).

[210]*Id.*

[211]*Id.* § 281(a); *see also supra* text accompanying note 101 (explaining the requirements of § 281(a)).

[212]*Id.*

[213]DEL. CODE ANN. tit. 8, § 281(a) (1991). The term "priority," as defined in § 281(e), "does *not* refer either to the order of payments set forth in subsection (a)(1)-(4) of this section or to the relative times at which any claims mature or are reduced to judgment." *Id.*

within a specified period.[214] Section 281(a)(4) thereafter states that these claims will be remitted by the dissolving corporation (1) if not rejected by the firm[215] or (2) if they are "mature, known and uncontested."[216] On the other hand, pending and future foreseeable claims are subject to a judicial conclusion regarding the amount and form of security reasonably likely to provide compensation to these claimants.[217] Section 281 subsequently requires the posting of security for the amounts determined by the court.[218]

For extrajudicial dissolutions, the amendments set forth three directives. First, a dissolving corporation must "make reasonable provision to pay all claims and obligations," including certain contingent contractual claims identified by the corporation.[219] Second, the directors must make reasonable provision for any claim then pending against the corporation.[220] Finally, the firm must make reasonable provision for compensating future unasserted claims that are likely to arise or become known to the corporation within ten years after the date of dissolution.[221]

To explore the application of the statutory amendments, assume a Delaware corporation has engaged in the research and development of a radioactive waste disposal system for one year. Assume further that, during the testing of a proposed disposal process, a malfunction occurs which results in the leakage of radioactive materials into a local water supply. Within six months of the incident, the following claims are outstanding against the company: (1) $10,000 in employee wages, due immediately; (2) $5,000 in rent, due over the next six months; (3) $35,000 to suppliers, due immediately; (4) $50,000 in mortgage payments, due over the next twelve months; and (5) pending personal injury suits seeking, in the aggregate, $75,000. Assume that, at the time of the accident, firm assets have a present value of $200,000. Because the corporation can logically predict numerous personal injury and property damage claims as a consequence of the malfunction, firm management elects to dissolve the business under sections 280 through 282.

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[214]DEL. CODE ANN. § 280(a)(1)(d), (a)(2), (a)(4) (1994).

[215]DEL. CODE ANN. tit. 8, § 281(a)(1) (1994).

[216]*Id.* § 281(a)(4).

[217]*Id.* § 280(c)(1), (c)(3).

[218]*Id.* § 281(a)(3).

[219]DEL. CODE ANN. tit. 8, § 281(b)(i)-(ii).

[220]*Id.*

[221]*Id.* § 281(b)(iii).

If the future foreseeable claims are valued at approximately $10 million, management must interpret the directives of section 281(a) to adopt a plan of distribution that will satisfy the firm's statutory obligations to present, contingent, and future claimants. Accordingly, the directors must determine what form of security arrangement preserves corporate assets for distribution to contingent and future claimants, yet does not compromise or extinguish existing contract and commercial rights of present creditors.

In the foregoing hypothetical, five facts are obvious. First, the company has assets with a present value of $200,000. Second, *liquidated* claims against the corporation equal $45,000. Third, *uncontested* claims that will mature within one year of dissolution total $55,000. Fourth, *contingent*, disputed claims that may mature during the three-year post-dissolution interval equal $130,000. Finally, *future foreseeable* claims total approximately $10 million.

Paragraphs (1) and (2) of section 281(a) require the corporation to pay all liquidated and uncontested claims and section 281(a)(3) mandates the posting of security for pending and future unasserted claims. Applying the facts to section 281(a), it seems indisputable that the $45,000 of liquidated claims are fully compensable under the statute. If so, complete remittance of the liquidated obligations reduces to $155,000 the corporate assets available for distribution subsequent to the firm's dissolution. Next, the $55,000 of uncontested claims that will mature within one year of the company's dissolution are entitled to full remittance as claims that, although not mature, are determined by corporate management to be legitimate obligations of the company. Under section 281(a), therefore, both mature (the employee wages and supplier debts) and unmature (the rent and mortgage obligations) claims will receive identical treatment at dissolution despite their temporal distinction. As such, firm assets are further reduced such that $100,000 remains for distribution to pending and future unknown claimants.

Assume that two plaintiffs thereafter sue the dissolved firm for personal injuries arising from the accident. Plaintiff A receives a $1 million trial court judgment within the statutory winding-up period. Plaintiff B (who is seeking $5 million against the corporation for injuries arising out of the same accident as plaintiff A) has yet to come to trial at the close of the three-year survival interval. What is required of the dissolving corporation vis-à-vis these plaintiffs under section 281(a)?

The *RegO* court interpreted the former statute to require equal treatment of plaintiffs A and B.[222] The ostensible justification for this conclusion was the term "priority" and its definition in section 281(e) that specifically rejects any reference "to the relative times at which any claims mature or are reduced to judgment."[223] By emphasizing the definition of priority under section 281(e), rather than the payment directives of section 281(a), the court concluded that section 281 required a dissolved corporation that "cannot both pay its present creditors and make adequate provision for contingent and future claims"[224] not to compensate its existing creditors in full, but to pay them ratably with its future claimants.[225] The court stated, however, that sections 281(a) and (e) did "not direct directors of a dissolved corporation to pay existing creditors only ratably when they have reason to know that the corporation will not be able fully to secure the payment of compensation to all foreseeable future claimants."[226]

After the court's conflicting signals regarding temporal priority among competing claimants, the question persists whether directors may, subject to the court's subsequent "fairness" review, adopt a security

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[222]*RegO*, 623 A.2d at 106.

[223]*See id.* (citing DEL. CODE ANN. tit. 8, § 281(e) (1991)).

[224]*Id.*

[225]*Id.*

[226]*RegO*, 623 A.2d at 108. According to RegO's plan and trust agreement, all firm assets were to be transferred to a trust for distribution to existing and future claimants. *Id.* at 100. Under the plan, a $500,000 interim limit capped both contingent and future products liability claims as well as certain other claims. *Id.* at 101. Administrative expenses were to be paid in full as a priority. *Id.* at 101 n.22. Pre-existing claims which were reduced to a judgment before the effective date of the trust, but which remained unremitted as of that date, were to be paid in full. *Id.*

Further, RegO statistics indicated that without an interim limit on contingent and future products liability claims, available funds would be exhausted in the year 1996. *Id.* at 100. On the other hand, with an interim limit, products claims arising out of more than 90% of all occurrences were projected to be paid as if no limit existed. *RegO*, Master's Final Report at 37-38. In addition, with an interim limit, funds were predicted to be available for the payment of products liability obligations up to the interim limit until the year 2000. *RegO*, 623 A.2d at 100.

Interestingly, the guardian supported an interim limit and a priority for administrative expenses but objected to any "priority" being given to pre-existing judgment creditors. *RegO*, Master's Final Report at 25-26. This position was interesting for three reasons. First, it sought to enforce the definition of "priority" in § 281(e), while explicitly rejecting the mandate of § 281(a) that RegO "prorate" its claims. Second, it endorsed a priority for administrative expenses (which, of course, included the guardian's attorneys' fees and costs) but not the full payment of claims held by existing judgment creditors. Finally, it advanced the guardian's personal economic interest in the case to the obvious detriment of existing creditors as well as the class of claimants the guardian was appointed to represent.

scheme that fully compensates liquidated debts at the expense of contingent and future foreseeable claims. The reasonable answer seems to be one that permits the greatest flexibility to directorial decisions that are made in good faith and in an informed manner in the post-dissolution interval.

In the preceding hypothetical, therefore, if the corporation elects not to appeal the $1 million judgment in favor of A, then the remaining $100,000 should be available for payment to A as partial satisfaction of that debt, notwithstanding that such a decision by the directors will consume all corporate assets. In the alternative, the corporate directors should retain the discretion to negotiate a settlement with A if management considers such an option to be in the best interest of legitimate claimants and the dissolving entity. An alternative that retains directorial discretion regarding payment of liquidated debts effectuates the reimbursement requirements of section 281(a) and also fulfills the contract expectations of the liquidated and undisputed, contingent contract creditors.

By contrast, in the foregoing hypothetical, if a court were to require protection of A's and B's claims, the court, in essence, would be divesting assets from a liquidated claimant in favor of preserving a *potential* claim of a contingent or future claimant. This analysis would be in direct conflict with commercial and contract law. Further, directors of the dissolving entity would be compelled to undertake a costly economic analysis of a "fair" scheme for prorating the various claims against the corporation. This analysis requires as its predicate a determination of the total amount owed to creditors, which amount can then be prorated among claimants.[227] Although this method of obtaining "security" for future distribution might seem appealing in principle, three factors illustrate the inherent uncertainty of eliciting the requisite total claims' value and, thus, the unreliability of the methodology of prorating contingent or anticipated claims.

First, any prorating formula must ascertain for what period security must be provided for all potential, future claimants.[228] Second, a prorating formula assumes total claims to be quantifiable — an endeavor

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[227]One claimant in the *RegO* litigation proposed the following prorating formula:

$$\text{Claims} \times \frac{\text{(Total Assets - Administrative Claims)}}{\text{Expected Total Value}}$$

See RegO, Master's Final Report at 49-50.

[228]In Delaware, this depends upon the court of chancery's selection of some interval between five and ten years post-dissolution.

that is intrinsically refutable. Third, a prorating formula assumes a requirement of ratable payment of *all* claims, with the possible exception of administrative obligations.[229]

If, as the court intimated in *RegO*, the pro rata condition is not absolute, the court must resolve the seeming friction between the payment mandates of section 281(a) and the "priority" language of section 281(e). If the term priority in section 281(e) is interpreted to prohibit the creation of priorities *within the same class of claims*, then sections 281 (a) and (e) are congruous.

For example, in the hypothetical, the liquidated and uncontested contingent claims were contractual obligations of the corporation that predated the firm's accident. These obligations were fully negotiated and voluntarily assumed by the contracting parties. Under a contractual analysis, therefore, it is unsound to assume that the parties to the subject commitments[230] accepted the risk of non-payment of services or capital as a consequence of an environmental accident by the firm. Consequently, this interpretation of "priority" — applicable *only within corresponding categories of claims* — is ostensibly buttressed by the payment divisions of section 281(a) that differentiate between contract and all other classifications of corporate claims.

Further, if the innovation to sections 280 through 282 lies in the posting of reasonable security for pending and future unknown tort claimants, then "prioritizing" according to the "relative times at which any claims mature or are reduced to judgment" achieves the legislative purpose of the enactments. On the other hand, to extend the definition of priority beyond the parameters of a particular class of claimants' compromises the bargained-for commitments of pre-existing creditors to the unfair advantage of claimants who exist in statistical analysis only.

In short, a suggested interpretation of present sections 281(a) and (e) is one that construes "priority" to require equal treatment among the same or similar groups of claimants, not temporal parity for mature debts and contingent or future unknown claims. Such a construction balances the directives of section 281(a) and the definition of priority in section 281(e) with the competing interests of contract and tort victims of corporate negligence or misconduct. This interpretation also reduces the incentive for existing creditors to seek the appointment of a receiver[231] that would

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[229]Again, this position directly conflicts with basic tenets of contract and commercial law.

[230]These parties would include employees, suppliers, and landlords or mortgagees.

[231]*See* DEL. CODE ANN. tit. 8, § 279 (1991) (permitting the appointment of a trustee or receiver for a dissolved corporation "on application of any creditor, stockholder or director of the corporation, or any other person who shows good cause therefor"); *id.* § 291 (permitting

undermine the effectiveness of the intended safe harbor of sections 280 through 282.

In the hypothetical, therefore, directors should be free to set aside the remaining firm assets for (1) full payment to A, (2) partial payment to A, and apportioned amounts for future payment to B and the other claimants, or (3) any other rational distribution plan that is adopted in an informed and good faith manner. Creditors who consider this directorial discretion to be disadvantageous may petition the court of chancery for the appointment of a receiver.

b. *Other Concerns*

In *RegO*, claimants raised a series of objections to the company's proposed plan and trust agreement. For the most part, the claimants' objections sought to replace post-dissolution directorial judgments with the claimants' retrospective considerations.[232] That is, the claimants desired to substitute their opinions of the disputed trust terms for those of RegO's directors.[233]

The claimants' objections raised two underlying and entwined legal issues. First, to what extent do traditional principles of corporate governance protect directorial decisions post-dissolution? Second, to what extent does a section 280(c)(2) hearing on "reasonable security" entail factual determinations of each challenged term in a proposed plan of security?

1. Theoretical Concerns

As to the former theoretical issue, the court in *RegO* held that "[w]hen directors of a dissolved Delaware corporation are, during the course of winding-up corporate affairs, required to make decisions affecting various classes of interest holders, they are protected from liability in doing so, so long as they act disinterestedly, with due care and in good faith."[234] As articulated, directorial judgments made during dissolution ostensibly are protected by the traditional business judgment rule.

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the appointment of a receiver for an insolvent corporation "on the application of any creditor or stockholder").

[232] *RegO*, Master's Final Report at 38-39.

[233] *Id.*

[234] *RegO*, 623 A.2d at 109 n.35.

Interestingly, section 281(a) references a similar standard for the review of directorial judgments that involve the payment of "mature, known and uncontested" claims.[235] Section 281(a)(4), however, is silent concerning director decisions that implicate pending or future unknown claimants. Because no viable reason exists for placing a greater burden of review upon directors of dissolving entities that have mature, pending, and future foreseeable claims, section 281(a) should be amended to provide business judgment-like protection for all corporate decisions executed at or during dissolution. Such managerial protection should, however, be accorded to directors without conferring legitimacy to any "duty to creditors." In essence, dissolution should place all claimants to the firm in a creditor-like category with the recognition that stockholder/creditor interests will be compensated only after outside creditor interests are paid or considered.

What remains unresolved is whether good faith directorial decision making should be presumed during an insolvency that pre-dates dissolution. Because insolvency is not a voluntary or fixed state of economic being, creditors could argue that a presumption of validity is not warranted. The fallacy of such a position is its apparent reliance on the alleged "duty to creditors" at insolvency and the conflict that such a duty has with traditional notions of corporate governance. If courts abandon the duty to creditors in favor of contractual protections for corporate claimants, then the directorial obligations of care and loyalty would apply at insolvency in the same manner as they would during firm viability.[236]

2. Procedural Concerns

A recurring theme in the *RegO* proceedings was the allegation by certain claimants that RegO illegally transferred its assets to a related entity for less than fair market value.[237] An initial inquiry, therefore, is the extent to which a section 280 hearing should be subject to factual

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[235]DEL. CODE ANN. tit. 8, § 281(a) (1994). Section 281(a) states: "In the absence of actual fraud, the judgment of the directors of the dissolved corporation or the governing persons of such successor entity as to the provision made for the payment of all obligations under paragraph (4) of this subsection [regarding payment of mature, known and uncontested claims] shall be conclusive." *Id.*

[236]*See infra* notes 505-29 and accompanying text (discussing the theoretical aspects of abandoning the corporate duty to creditors).

[237]*RegO*, 623 A.2d at 103.

resolutions of complex contractual, commercial, or tort allegations by interested claimants.[238]

For example, consider a publicly-held Delaware corporation which manufactures and nationally distributes a fungicide that is later determined to cause crop damage. Due to anticipated litigation costs, firm management elects to dissolve the business under Delaware sections 280 through 282. At the time of dissolution, the firm has three categories of liabilities: (1) state tax liability; (2) general, undisputed trade liabilities that will mature within weeks of the corporation's dissolution; and (3) products liability claims either for occurrences that arose pre-dissolution or will arise during the three-year post-dissolution interval, *or* that may arise subsequent to that period. Further assume that, in the aggregate, all claims against the dissolved entity exceed present or projected corporate assets and that the company challenges all liability ensuing from the products suits.

The procedural dilemma presented to the court of chancery under current section 280(c)(2) is two-fold: (1) whether the court must undertake factual hearings on each contested products claim where such claims have been initiated in a foreign jurisdiction and, pursuant to principles of conflicts of law, are to be decided under the substantive law of that forum; and (2) whether the court is required to accord full faith and credit to foreign judgments in such suits where those judgments eliminate all security for future distributions to contingent or anticipated products claimants in contravention of the apparent purpose of Delaware's dissolution statutes.

Two alternative resolutions are possible. First, in 1994, section 280(c) was amended to require dissolving corporations to petition the court of chancery for a determination of the amount and form of security reasonably likely to provide compensation for pending claims and for claims that foreseeably will arise in a five-to-ten year interval post-dissolution.[239] In the hypothetical, therefore, the court of chancery must resolve at least two security issues: (1) the quantity and form of security for the claims which arose pre-dissolution but which have not been reduced to judgment, and (2) the quantity and form of security for the future unasserted claims.

As to the pending claims, the court could simply require security in the amount for which plaintiffs have sued. The obvious attractiveness of

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[238]Intertwined in this query are the principles of conflicts of law and full faith and credit. Resolution of this inquiry is essential if court and attorney costs are to be confined within reasonable boundaries in order to preserve corporate property for distribution to creditors.

[239]DEL. CODE ANN. tit. 8, § 280(c) (1994).

this option is that the corporation, the claimants, and the court are not obliged to present or hear extensive evidence regarding disputes that are external to the dissolution. It is also appealing for its simplistic application.

Such an alternative should be rejected, however, because it permits litigation-inspired plaintiffs' counsel to usurp the legitimate decision-making responsibility of directors. It also ignores, and militates against, the value of negotiated settlements of claims. Instead, it is suggested that the legislature amend sections 280 and 281 to clarify that the hearing on security will weigh certain limited evidence. These hearings will be cost-effective if they also permit testimony on the proposed claims assertion date amendment.[240] By marginally expanding the security hearings, the court is better able to tailor the amount and form of security for particular corporations.

In sum, the Delaware enactments should be amended to clarify that sections 280 through 282 are intended to be summary dissolution actions. Accordingly, absent a showing of overt illegality, actual fraud, bad faith, or compensable injury to a stockholder, issues considered in the dissolution will be narrowed to those involving the sufficiency of security.[241] In this manner, lengthy and costly fact-findings are avoided because dissolution actions arguably are concerned with the administration of corporate assets and affect individual interests only incidentally.

Another alternative is that which requires the court of chancery to hear and decide all factual disputes that tangentially affect a claimant's contention over a provision of a proposed security arrangement. The clear disadvantage to this alternative is its depletion of the corporate estate through attorneys' fees and court costs in a preliminary stage of a firm's dissolution.

Because the latter alternative appears economically wasteful, the former is that recommended for future section 280 proceedings. An obvious flaw to this alternative, however, arises in the case where, as in the hypothetical, the dissolving entity disputes all liability for future or contingent claims — a position that, if accurate, would render the corporation solvent and thus free to ignore the section 281 mandate for

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[240]*See supra* note 201 and accompanying text.

[241]In this sense, §§ 280-282 would be interpreted similarly to § 273 which permits a summary dissolution of a joint venture having two stockholders. *See* DEL. CODE ANN. tit. 8, § 273 (1991). *See also In re* Southern One-Stop, Inc., No. 7500, 1986 WL 13978, at *1 (Del. Ch. Dec. 3, 1986), *reprinted in* 12 DEL. J. CORP. L. 1208, 1210 (1987) (stating that petitioner could not pursue a claim of diversion of a corporate opportunity in a § 273 action).

ratable payments where funds are insufficient to compensate all creditors fully. Because this scenario will occur in more circumstances than where the dissolved enterprise concedes liability or damages, two observations are warranted.

First, if section 280(c)(2) is amended to provide that "claims" and "obligations," as referred to in that statute, do not include statistically probable or provable claims, then a dissolving corporation only must challenge those claims that are pending and contested. Admittedly, this amendment might encourage directors to contest all contingent claims and thereby create additional procedural ordeals for a reviewing court. Accordingly, a second observation is required.

If section 280(c)(1) and (3) are narrowly interpreted to exclude all testimony on the merits of foreign suits and to permit only expert testimony as to the statistical probability of plaintiffs' success (both substantively and economically) in contingent suits, the market efficiency and predictability purposes of sections 280 through 282 will be fulfilled. In this regard, the recommended amendment would permit interested parties (including the *guardian ad litem*) to introduce only that expert evidence that bears directly upon the question of the sufficiency and fairness of security under section 280. Such judicial efficiency is, however, not achieved at the expense of due process.

Three distinct benefits follow from this interpretation. First, summary dissolution under section 280 reduces the debilitating litigation costs associated with adversarial hearings on issues tangential to a corporate dissolution. Thus, the statute conserves corporate assets for distribution to legitimate claimants. Second, the recommendation sustains, in the reviewing court, the right to set aside an approved plan of distribution where critical expert testimony is later adduced to be incomplete or inaccurate. Third, directorial discretion is retained for managers who oversee corporate dissolutions. The sole disadvantage of the suggested interpretation is its lack of finality once a security arrangement has proceeded through a section 280 hearing. This disadvantage, however, is more imagined than real given the right of certain creditors to seek the appointment of a receiver notwithstanding a section 280 dissolution. Certainly, any interpretation which allows mini-trials within a section 280 proceeding contravenes any tort reform policy inherent in Delaware's dissolution amendments.[242]

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[242]One conflicts of law dilemma that is not resolved by the recommended construction is that in which a claimant in a foreign jurisdiction seeks to impose the *dissolution law* of the forum wherein the alleged tort or breach of contract occurred. Certainly, the internal affairs doctrine encourages the application of the dissolution law of the corporate defendant's state of