NONCONSENSUAL THIRD-PARTY RELEASES IN THE SPOTLIGHT: CHALLENGING THE LIMITS OF THE LAW AND DRAWING CONGRESSIONAL SCRUTINY

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INTRODUCTION

Nonconsensual third-party releases, although around for some time, have become controversial in several recent bankruptcy cases arising at least in part in response to mass tort claims, such as *Purdue Pharma, Boy Scouts of America,* and *USA Gymnastics*. The releases are now so worrisome that Congress is paying attention with a recent hearing and two newly-introduced bills to constrain the practice. Discussion of the fairness and legality of such releases has likewise been amplified during the *Purdue Pharma* plan confirmation process. The issue is ripe with real-time major case controversies such as the recent confirmation of the *Purdue Pharma* chapter 11 plan, a plan principally based on nonconsensual third-party releases and subject to appeal. Is change on the horizon?

Our purpose is not to predict the future, but to provide background on the practice of including third-party releases in plan settlements, including reasons for allowing or limiting them. We will discuss the proposed legislation and consider nonconsensual third-party releases in relation to other controversial bankruptcy practices, namely venue shopping and equitable mootness, each of which support the viability of third-party releases in confirmed chapter 11 plans and so too are now under scrutiny. Driven by a practical, deal-maker mindset, have chapter 11 stakeholders gone too far?

DISCUSSION

Nonconsensual, third-party releases are increasingly an integral part of a chapter 11 plan. The term itself is descriptive. The release absolves third-party nondebtors of their liabilities. As the release is entered against the wishes of certain creditors, it is nonconsensual.[1]

And they are potent. Where such release is approved, a plaintiff loses the right to sue the nondebtor party merely because the dispute became entangled in a debtor's chapter 11 bankruptcy. The nondebtor defendant receives the release, usually in exchange for a large payment to the estate and sometimes other consideration, but without ever subjecting itself to the rigors and transparency of a bankruptcy case. The release, firmly embedded as an essential part of a debtor's plan, is then submitted for approval by a bankruptcy judge, typically during the plan confirmation process.

Practitioners engineer cases from the very beginning to win approval of nonconsensual third-party releases that aim to broadly protect well-resourced nondebtors from the troubles of liquidating through the bankruptcy process. Nondebtors help too. They threaten to pull the plug and doom the plan if the releases are not granted. Wealthy nondebtors such as the Sackler Family in *Purdue Pharma* also may use aggressive offshore asset protection strategies that render collection costly and speculative, making settlement relatively attractive. Judge Drain called the Sackler trust collection problem "a bitter result, B-I-T-T-E-R" and "incredibly frustrating."[2] Preplanning works.

RELEASES COME FAST: CREDITORS BE NIMBLE, CREDITORS BE QUICK

The process to settle nondebtor claims often occurs at the very start of the debtor's case. The debtor, in coordination with the nondebtor who is contemplating settlement and looking for a future broad release from all litigation, will request an injunction to stay plaintiffs and other claimholders in any pending litigation or disputes. This injunction then bars creditors from pursuing nondebtors even though the nondebtors are outside the protection of the automatic stay.

The argued rationale for the injunction is to protect the debtor from distractions and costs from lawsuits against the nondebtor, and from depletion of estate assets, even if the nondebtor is no longer operating the business.[3] "Distraction" and the argued rationale for the injunction is to protect the debtor from distractions and costs from lawsuits against the nondebtor, and from depletion of estate assets, even if the nondebtor is no longer operating the business. "Distraction" and "depletion" may certainly happen, but in other types of civil litigation outside bankruptcy, including mediation, obtaining a stay of the underlying litigation is not the norm. In bankruptcy, however, the request for preliminary injunctions is often successful and could occur on day one of the debtor's chapter 11 case.

This practice may catch creditors by surprise, and leave them fighting an uphill battle. Although the injunction may be approved as preliminary or temporary, once granted it is very difficult to lift the injunction if the prospects of settlement and proposing a confirmable plan seem positive. Creditors facing such injunctions must remain vigilant, since once effectively stayed, they may never be able to resume their lawsuits, even if they oppose the proposed settlement. The plan then replaces the temporary injunction with a permanent settlement and nonparty release. From day one, creditors with claims against nondebtors are forcibly swept into the debtor's bankruptcy and may remain there, without a lifeboat.

For example, in *Purdue Pharma*, the first motion for a preliminary injunction from commencing or continuing action – seeking to enjoin over 2,625 lawsuits filed by governmental and private

1 The statements in this article are the author's own and do not reflect the opinions or viewpoints of Saul Ewing Arnstein & Lehr LLP or her colleagues at the firm. While this article mainly focuses on nonconsensual third-party releases, chapter 11 plans are complex and often include many types of releases, which could be releases granted by the debtor, consensual releases (sometimes deemed so for unimpaired or nonvoting creditors), exculpations for insiders, senior lenders, professionals and so on, permanent injunctions, channeling injunctions, trust procedures, bar orders, and other protective mechanisms for settlement parties, plan proponents, and other interested stakeholders.

2 *See* Transcript of bench decision confirming the Purdue Pharma chapter 11 plan, State of Washington Notice of Appeal, No. 19-23649-rdd, Dkt. No. 3724 (Sept. 1, 2021).

3 See In re Purdue Pharma L.P., No. 19-08289-rdd, Dkt. No. 2, 2-1 (Bankr. S.D.N.Y. Sept. 18, 2019). The proposed order included a finding by the court that continuation of the nondebtor litigation against nondebtors not subject to bankruptcy court supervision would "result in irreparable harm to the Debtors and their reorganization, including by subjecting the Debtors to substantial, but ultimately unproductive, costs, materially lessening the Debtor's ability to maximize value and recovery to the public and potential estate stakeholders, ... [and] would significantly distract the Debtors from vital bankruptcy proceedings ... all to the substantial detriment of the Debtors and their estates. Moreover, the Debtors have demonstrated that any harm to the [creditors] ... from a stay is outweighed by the irreparable harm that the Debtors will suffer in the absence of preliminary injunctive relief." The Purdue Pharma chapter 11 case docket is available free of charge at the Prime Clerk claims agent website, https://restructuring.primeclerk.com/purdue pharma/Home-DocketInfo.

claimants against the debtors and related parties – was filed on September 18, 2019, immediately after commencing the chapter 11 cases.[4] After a contested hearing that involved many objecting creditors, on October 11, 2019, the court granted the injunction as requested by the debtors and their insider related parties.[5] The bankruptcy court then extended the preliminary injunction many more times to essentially span the duration of the case.[6]Once granted, even if vigorously contested, a bankruptcy court may find it difficult to end an injunction because the grounds supporting the initial grant likely remain in place throughout the plan confirmation process.[7]

In another example, the bankruptcy court in the *FirstEnergy Solutions* chapter 11 case asserted primacy over and enjoined a federal agency, the Federal Energy Regulatory Commission or FERC, within days of the chapter 11 filing,[8] a decision that was later reversed by the Sixth Circuit on direct appeal.[9] With the possibility of a stay on nondebtor litigation or even regulatory oversight responsibilities being issued on day one, creditors must be alert and then remain vigilant.

Aware of the potential for bankruptcy intervention, such as the perpetual preliminary injunction and nonconsensual third-party releases discussed above, plaintiffs representing thousands of ovarian cancer victims took preemptive action. Plaintiffs, already stuck in bankruptcy with a Johnson & Johnson supplier called Imersys Talc, asked the bankruptcy judge overseeing that case for an injunction to prevent J&J from entering into a "divisive merger" known as the "Texas Two-Step."[10] In executing this dance step, J&J could shield good assets from any bankruptcy process by creating an affiliate to assume liabilities and then dumping the talc liability-laden affiliate into bankruptcy, allowing J&J to then fund a plan settlement in exchange for nonconsensual third-party releases.[11]The Imersys Talc bankruptcy judge denied the plaintiffs' request for an injunction.[12]

Practitioners in asbestos-related bankruptcy cases have matured this strategy, which burdens an affiliate with the asbestos liabilities and then only that entity files the chapter 11 case, protecting the healthy businesses from further liability and from bankruptcy itself.[13] It is now a routine way to shield nondebtors from the full brunt of continued litigation and ultimately from liability.

An early injunction appears to serve the aspirations of a bankruptcy proceeding, to finally resolve all disputes in one forum. The forum, incidentally, is selected by the debtor and its advisors and main stakeholders, many of whom will benefit from nonconsensual plan releases. Proponents of the injunction and ultimate settlement argue that bankruptcy provides vast efficiency benefits over myriad, value-destroying, piece-meal litigation in dealing with mass tort

4 *See In re Purdue Pharma L.P.*, No. 19-08289-rdd, Dkt. Nos. 2, 3 (Bankr. S.D.N.Y. Sept. 18, 2019). The preliminary injunction sought by the debtors extended to "former or current (a) owners (including any trusts and their respective trustees and beneficiaries), (b) directors, (c) officers, (d) employees, and (e) associated entities of the Debtors that were or could have been commenced before the commencement of the case ("Related Parties," and the claims against them described in this paragraph, the "Related-Party Claims") for 270 days from entry of the injunction. Id. (proposed order). The *Purdue Pharma* entities filed their chapter 11 cases on September , 2019.

5 *See In re Purdue Pharma L.P.,* No. 19-08289-rdd, Dkt. Nos. 82, 89 (Bankr. S.D.N.Y. Oct. 11, 2019 & Oct. 18, 2019).The original and amended orders enjoined the plaintiffs from commencing or continuing any activity against the "Debtors and/or Related Parties" through November 6, 2019. The bankruptcy court reserved the right to extend the preliminary injunction period. This order was amended to, among other things, include tolling provisions.

6 For a list of motions and hearings that ultimately extended the initial preliminary injunction to span the case, see the Eighteenth Amended Order Pursuant to 11 U.S.C. § 105(a) Granting Motion for a Preliminary Injunction extending the preliminary injunction through June 16, 2021, see In re Purdue Pharma L.P., No. 19-23649-rdd, Dkt. No. 2897 (Bankr. S.D.N.Y. May 21, 2021); No. 19-08289-rdd, Dkt. No. 270 (Bankr. S.D.N.Y. June 2, 2021). The Nineteenth Amended Order was signed on June 17, 2021 and was intended by the debtors to bridge the plan confirmation hearing. No. 19-08289-rdd, Dkt. No. 269-70, 274 (Bankr. S.D.N.Y. June 2, 2021 & June 17, 2021). The Twentieth Amended Order was signed on August 30, 2021 and extended the preliminary injunction through September 1, 2021. No. 19-08289-rdd, Dkt. No. 286 (Bankr. S.D.N.Y. August 30, 2021). The bankruptcy court confirmed Purdue Pharma's Eleventh Amended Joint Chapter Plan of Reorganization on September 1, 2021. See Notice of Appeal, No. 19-23649-rdd, Dkt. No. 3724 (Bankr. S.D.N.Y. Sept. 1, 2021) (The notice of appeal includes transcript of bench ruling.).

7 *See* Rick Archer, Purdue Asks To Extend Opioid Suit Shield To End Of Summer, LAW 360 (June 3, 2021).

8 *See In re FirstEnergy Solutions Corp.*, No. 18-3787 (6th Cir. Dec. 12, 2019).

9 *Id.*

10 For a discussion of the Texas Two-Step and some recent asbestos cases, see Adam Levitin, The Texas Two-Step: The New Fad in Fraudulent Transfers, Credit Slips Blog, posted July 19, 2021.

11 *See* Felix Simon, The Texas Two-Step, AXIOS (July 22, 2021), available at www.axios.com/johnson-and-johnson-baby-powder-bankruptcy-dec4874c-e02b-4076-817d-83de74d6196c.html.

12 *See* Steven Church, J&J Defeats Effort to Block Texas Corporate Restructuring Move, BLOOMBERG LAW (Aug. 26, 2021), available at www.bloomberglaw.com/pharma-and-life-sciences/j-j-defeats-effort-to-block-texas-corporate -restructuring-move.

13 For a recent example, *In re Paddock Enterprises, LLC*, a Delaware LLC affiliate of Owens-Illinois Group Inc. created in 2019 for this purpose, No. 2010028, Dkt. No. 2 (Bankr. D. Del. Jan. 6, 2020) (First-Day Declaration), docket and case information available at https://cases.primeclerk.com/paddock/Home-Index. See Andrew Scurria, Asbestos Costs Drive Owens-Illinois Affiliate to Bankruptcy, WSJ PRO BANKRUPTCY (Jan, 6, 2020), available at https://www.wsj.com/articles/asbestos-costs-drive-owens-illinois-affiliate-to-bankruptcy-11578316195.

cases. Proponents contend that without the injunction, settlement and reorganization is impossible. Said positively, with the injunction all things are possible. But this rhetorical flourish may overstate the actual risks and benefits.

A few remaining nonconsenting creditors, such as the State of Washington and District of Columbia in *Purdue Pharma*, for example, do not alone threaten devastating outcomes, and future settlement remains possible. Is it fair or proper for a bankruptcy court to deny these creditors their day in court against nondebtors? By cutting off lawsuits without consent, do nonconsensual third-party releases undermine the very foundation of the adversarial judicial system?

POTENTIAL ALTERNATIVES EXIST, BUT ARE THEY BETTER?

Nondebtors could still file their own bankruptcy cases to stay the litigation, but they would then face the transparency and liquidation demands of a bankruptcy process. This they seem reluctant to do if they can buy a broad release through another entities' bankruptcy. Does denying nonconsenting creditors their choice to pursue their cases, outside of bankruptcy or in a separate bankruptcy case, seem consistent with fairness and due process? Bankruptcy is not necessarily less expensive in the large plan settlement chapter 11 cases, which accrue hundreds of millions of dollars in attorneys' fees.[14]

One alternative to bankruptcy is multi-district litigation or "MDL" procedures in federal district court for mass tort cases, including opioid-related lawsuits.[15] The MDL that consolidated prescription-related opioid lawsuits filed by public entities has produced a settlement with four defendants or around $26 billion to fund community programs.[16]

Potentially, MDL proceedings could result in efficiencies and controlled attorneys' fees to preserve recovery for public health or victim compensation. District Court Judge Polster recently capped attorneys' fee at 15% of the total client award, finding any fee above the cap "presumptively unreasonable."[17] According to Judge Polster, the cap was necessary to maximize the settlement proceeds to communities affected by the opioid addiction crisis.[18] Bankruptcy courts and the regulatory scheme that oversees bankruptcy cases seem less equipped to control professional fees and expenses and maximize creditor recoveries.[19] A litigation trust mechanism, as was used in the 9/11 and *Deepwater Horizon* mass tort cases, provides another potential approach; however, both examples are not without criticism.[20]

The Bankruptcy Code includes a codified litigation trust solution with a channeling injunction, but only in asbestos cases outside of

14 Mike Baker, "Staggering" Legal Fees in Boy Scouts Bankruptcy Case, N.Y. TIMES (May 11, 2021) (noting that by August 2021, fees "could reach $150 million" and "is the money taken off the top of what could be offered to victims, [and] have become a rising point of contention"). The bankruptcy judge overseeing the Boy Scouts' case, Judge Laurie Selber Silverstein, call the fee totals "staggering." *Id.*

15 See *In re National Prescription Opioid Litigation*, No. 17-md-02804 (N.D. Ohio), Polster, J.

16 See Nathaniel Weixel, Drug Companies Reach Tentative $26 billion National Opioid Settlement, THE HILL (July 21, 2021), available at https://thehill.com/policy/healthcare/564161-drug-distributors-reach-26-billion-opioid-settlement-agreement-with-states. For an example of an MDL order establishing a settlement fund, In re National Prescription Opioid Litigation, No. 17-md-02804 Dkt. No. 3828 (N.D. Ohio Aug. 12, 2021).

17 *See* Nate Redmond, Lawyers' Fees from $26 Bln Opioid Settlement Capped at 15%, REUTERS (Aug. 9, 2021) ("A contingent fee in excess of the distributional award under the Settlement Agreements is presumptively unreasonable," quoting Judge Polster.). Located at www.reuters.com. The total settlement pool reserved for attorneys' fees and expenses is around $2.3 billion. *Id.*

18 *Id.*

19 *See* Rapoport, Nancy B., Rethinking Professional Fees in Chapter 11 Cases (2010). Scholarly Works. 17, available at https://scholars.law.unlv.edu/facpub/17.

20 Congress established the September 11th Victim Compensation Fund (VCF) in 2001 to compensate victims of the 9/11 attacks, a program that distributed $7 billion to victims and their families (who agreed to broad releases as part of their settlements), and was reopened in 2011 to compensate 9/11 victims diagnosed with a 9/11-related illness. See "September 11th Victim Compensation Fund: Compensation of Claims," Federal Register Notice, Vol. 83, No. 192, Oct. 3, 2018, available at https://www.govinfo.gov/content/pkg/FR-2018-10-03/pdf/2018-21490.pdf. For more information, visit www.vcf.gov.

The Deepwater Horizon Explosion also resulted in an MDL proceeding in the U.S. District Court for the Eastern District of Louisiana, MDL - 2179 Oil Spill by the Oil Rig "Deepwater Horizon" (Barbier, J.) to settle claims arising from 3,000 lawsuits relating to the death of 11 individuals and damages caused by the Deepwater Horizon Explosion that released millions of gallons of oil into the Gulf of Mexico. See the court's website at http://www.laed.uscourts.gov/oilspill/oilspill.htm. Also shortly after the 2010 explosion, BP created the Gulf Coast Claims Facility with $20 billion from current and future earnings to compensate victims and address environmental liabilities, in exchange for releases by victims accepting compensation from the fund. See Jonathan Weisman And Guy Chazan, BP Agrees to $20 Billion Fund, WSJ (June 17, 2010), available at https://www.wsj.com/articles/SB10001424052748704198004575310571698602094.

After some controversy about claims processing and concerns with the administrator Kenneth Feinberg (the same administrator for the 9/11 fund) who was paid by BP to administer the program, it eventually fell under court supervision in 2013. For additional information on the settlement funds, see Deepwater Horizon Court-Supervised Settlement Program, available at https://www.deepwaterhorizonsettlements.com/. For a comparison of the 9/11 and Deepwater Horizon fund programs, and criticism of both approaches, see Linda S. Mullenix, Prometheus Unbound: The Gulf Coast Claims Facility as a Means for Resolving Mass Tort Claims - A Fund Too Far, 71 La. L. Rev. 819 (2011), available at: https://digitalcommons.law.lsu.edu/lalrev/vol71/iss3/3.

section 524(g).[21] Reform could include revision to the Bankruptcy Code to expressly broaden application of that section to non-asbestos mass tort cases.[22] Without such express statutory authority, bankruptcy courts tenuously rely on their general powers of section 105(a) to approve plans with channeling injunctions in non-asbestos cases. Procedures and practices have developed in bankruptcy courts to handle mass tort cases outside section 524(g), lending further confidence in bankruptcy as an appropriate forum.[23] Bankruptcy seems likely to remain a preferred forum for mass tort cases if debtors and their nondebtor stakeholder like the outcomes, so long as the law permits it.[24]

21 *See* 11 U.S.C. § 524(g) (permitting channeling injunctions implemented as part of a plan trust to satisfy personal injury, wrongful death, and property-damage claims "allegedly caused by the presence of, or exposure to, asbestos or asbestos containing products," id. at 524(g)(2)(B)(i)(I)).

22 *See* Crowell & Moring, A Look Back at Mass Tort Bankruptcy Cases in 2019 – Asbestos and Beyond, Client Alert (Jan. 22, 2020), available at https://www.crowell.com/NewsEvents/AlertsNewsletters/all/A-Look-Back-at-Mass-Tort-Bankruptcy-Cases-in-2019-Asbestos-and-Beyond.

23 *See*, e.g., S. Elizabeth Gibson, Judicial Management of Mass Tort Bankruptcy Cases, Federal Judicial Center (2005), available at https://www.uscourts.gov/sites/default/files/gibsjudi_1.pdf.

24 For a discussion of the evolution of bankruptcy as a forum for mass tort litigation after Johns-Manville, the pioneering asbestos case that inspired section 524(g), see Paul, A. et al., Resolving Mass Tort Liability Through Bankruptcy, 37th Annual Southeastern Bankruptcy Law Institute, April 14-16, 2011, available at https://sbli-inc.org/archive/2011/documents/BB_Paul.pdf.

A CIRCUIT COURT SPLIT DRIVES RELEASE-DRIVEN PLANS TO RELEASE-FRIENDLY CIRCUITS

The specific reference to asbestos litigation trusts – and no other type of mass tort cases – supports a view that nonconsensual third-party releases are not authorized under the Code.[25] Opponents of nonconsensual, third-party releases also observe that another sub-part paragraph of 524, section 524(e), limits the bankruptcy discharge to the debtor.[26] This position is described as a minority view and is held by the Fifth,[27] Ninth,[28] and Tenth[29] Circuits. These circuits generally bar nonconsensual

25 *See* G. Marcus Cole, A Calculus without Consent: Mass Tort Bankruptcies, Future Claimants, and the Problem of Third Party Non-Debtor Discharge, 84 IOWA L. REV. 753, 775-77 (1999) (describing approval of nonconsensual third-party releases as "judicial overreaching unwarranted by the circumstances, unauthorized by the Code, and destructive of the rule of law," id. At 780.)

26 *Id.* at 761-70. See 11 U.S.C. § 524(e), which provides that [e]xcept as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

27 *See In re Vitro S.A.B. de CV*, 701 F.3d 1031 (5th Cir. 2012); In re Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009).

28 *See* In re Lowenschuss, 67 F.3d 1394 (9th Cir. 1995); In re Am. Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989); see also In re Yellowstone Mountain Club, LLC, 460 B.R. 254 (Bankr. D. Mont. 2011).

29 *See In re Western Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990); see also In re Digital Impact, Inc., 223 B.R. 1 (Bankr. N.D. Okla. 1998).

third-party releases. However, they have approved consensual releases and exculpation clauses protecting bankruptcy professionals and others.[30] At risk of oversimplification, because these circuit's broad view of section 524(e) prohibits any discharge to nondebtors, nonconsensual third-party releases, which essentially do that, are barred.

Circuits that allow these releases, however, more narrowly read 524(e) and buttress the argument with the general powers under section 105, relying upon factor tests that vary among the circuits. This is called a majority view. The circuits that find authority for nonconsensual third-party releases are the Second,[31] Third,[32] Fourth,[33] Sixth,[34] Seventh,[35] and Eleventh[36] Circuits. The specific circuit-level guidance differs among them, and consistency in rulings is sometimes difficult to find, even between bankruptcy courts in the same district. This variability in part reflects the fact-intensive, case-by-case approach used by the courts when evaluating the appropriateness of nonconsensual third-party releases. Finally, although the First[37] and Eighth[38] Circuits do not have circuit-level precedent on the issue, there are lower court decisions in each circuit that support nonconsensual third-party releases through application of the *Master Mortgage* five-factor test,[39] a widely-adopted test formulated by the U.S. Bankruptcy Court in the Western District of Missouri, in the Eighth Circuit.

The existence of this circuit split influences the venue selection for the bankruptcy filing. If nonconsensual third-party releases are sought to protect nondebtors who may contribute to the plan in exchange for such releases, those debtors will file the case in a circuit that recognizes the releases. Thus mass tort cases find their way into Delaware to access third circuit precedent or the Southern District of New York to access second circuit precedent. Debtors access these courts (or any other court with favorable law) by utilizing the flexible provisions of the bankruptcy venue statute to file where an affiliate has its state of incorporation or assets.[40]

BANKRUPTCY HOLDS THE EDGE: RELEASES, CONTROL, AND VENUE EQUALS LEVERAGE

Mass tort defendants have reasons to prefer filing a bankruptcy. A major advantage to the bankruptcy process is the power to compel plan settlement discussions and bind nonconsenting creditors. This compulsion can extend to a plan with broad nonconsensual third-party releases. Other bankruptcy doctrines such as equitable mootness then protect the approved plan against any appeals, which is briefly introduced below. Taken together, bankruptcy practices and doctrines shift leverage away from creditors and over to debtors and the

30 *See In re PG&E Corp*., 617 B.R. 671 (Bankr. N.D. Cal. 2020) (approving opt-in consensual releases and exculpatory provisions in plan); Blixseth v. Credit Suisse, 961 F.3d 1074 (9th Cir. 2020) (permitting a "narrow exculpation clause" releasing nondebtors for liabilities arising from activities during the plan process).

31 *See In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005); see also In re Aegean Marine Petroleum Network, Inc., 599 B.R. 717 (Bankr. S.D.N.Y. 2019); In re Genco Shipping & Trading Ltd., 513 B.R. 233 (Bankr. S.D.N.Y. 2014).

32 *See In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000); see also In re Lower Bucks Hosp., 571 F. App'x 139 (3d Cir. 2014); In re Millennium Lab Holdings II, LLC, 575 B.R. 252 (Bankr. D. Del. 2017); In re Tribune Co., 464 B.R. 208 (Bankr. D. Del. 2011); In re Congoleum Corp., 362 B.R. 167 (Bankr. D.N.J. 2007).

33 *See Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344 (4th Cir. 2014); In re A.H. Robins Co., Inc., 880 F.2d 694 (4th Cir. 1989).

34 *See In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002); In re FirstEnergy Solutions Corp., 606 B.R. 720 (Bankr. N.D. Ohio 2019).

35 *See In re Airadigm Commc'ns, Inc.*, 519 F.3d 640 (7th Cir. 2008); In re Ingersoll, Inc., 562 F.3d 856 (7th Cir. 2009); In re Specialty Equip. Cos., Inc., 3 F.3d 1043 (7th Cir. 1993); see also In re Berwick Black Cattle Co., 394 B.R. 448 (Bankr. C.D. Ill. 2008). The Seventh Circuit finds support for nonconsensual releases under section 105's general powers to carry out the provision of the Code and section 1123(b)(6), which provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title."

36 S*ee In re Seaside Eng. & Surv'g, Inc*., 780 F.3d 1070 (11th Cir. 2015); see also In re Winn-Dixie Stores, Inc., 356 B.R. 239 (Bankr. M.D. Fla. 2006); In re Friedman's, Inc., 356 B.R. 758 (Bankr. S.D. Ga. 2005).

37 *See In re Chicago Invests., LLC*, 470 B.R. 32 (Bankr. D. Mass. 2012); In re Quincy Med. Center, Inc., No. 11-16394-MSH, 2011 WL 5592907 (Bankr. D. Mass. Nov. 16, 2011); In re Mahoney Hawkes, LLP, 289 B.R. 285 (Bankr. D. Mass. 2002) (adopting the Master Mortgage factor test).

38 *See In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994) (establishing widely used factor test); see also *In re Archdiocese of St. Paul and Minneapolis*, 578 B.R. 823 (Bankr. D. Minn. 2017).

39 The five factor test includes: (1) an identity of interest between the debtor and the nondebtor such that a suit against the nondebtor is essentially a suit against the debtor or will deplete the estate; (2) the nondebtor has contributed substantial assets to the reorganization; (3) the injunction is essential to the reorganization, and without it, there is little likelihood of success; (4) a substantial majority of creditors agree to the injunction, and the impacted class(es) has "overwhelmingly" voted to accept the proposed plan treatment; and (5) the plan provides a mechanism for the payment of all, or substantially all, of the claims of the class(es) affected by the injunction. *In re Master Mortg*. 168 B.R. at 935.

40 28 U.S.C. § 1408. See Eric Rosen, "The Reason Bankruptcy Venue Reform is Needed Now," *Commercial Law World, vol. 35, issue 3* [this issue – ed.] Venue shopping often means a filing in a forum other than the location of the debtor's headquarters. For example, *Boy Scouts* filed in Delaware through a newly organized LLC, Delaware BSA, LLC, although it is based in Fort Worth, Texas, in the Fifth Circuit. The Fifth Circuit frowns upon nonconsensual, third-party releases. *Purdue Pharma* filed in the Southern District of New York (in nearby White Plains), although its headquarters are located in Stamford, Connecticut, in the First Circuit. The First Circuit, although likely supportive of nonconsensual third-party releases under appropriate circumstances, lacks circuit-level precedent allowing nonconsensual, third-party releases.

nondebtor stakeholders, who then drive the chapter 11 case.

If the company is prepared for a change of control or liquidation, there are advantages in bankruptcy. This is especially true for nonprofit debtors without shareholders. Many nonprofit mass tort defendants have chosen bankruptcy as their collective settlement forum, including *Boy Scouts of America*, *USA Gymnastics*, and Catholic dioceses throughout the country. Usually the plans proposed in such cases enjoin and then release claims against nondebtors over the objection of nonconsenting creditors.

In *Boy Scouts of America*, only the national organization filed a chapter 11 case, to protect around 250 local councils from bankruptcy themselves, although the councils own most of the property available for settlement and are where the alleged tort claims occurred.[41] By shielding the local councils, the national organization bore the brunt of the bankruptcy process and achieved a plan settlement with *Boy Scouts of America* contributing $250 million and the local councils up to $600 million, in exchange for broad releases of sex-abuse related claims.[42] The local councils benefit from a nonconsensual channeling injunction and creation of a settlement trust for abuse victims, with related nonconsensual third-party releases as "necessary to effect a meaningful and final resolution" of the abuse victim claims.[43] The plan also includes an opt-out release provision for consensual releases.

This strategy is possible only because *Boy Scouts of America* created a Delaware entity to satisfy the venue requirement to enter Delaware's bankruptcy court.[44] Chapter 11 practitioners that direct where cases are filed can leverage flexibility in the venue statute to file cases in jurisdictions and with judges they view as good for the case. Opposing the debtors' chosen venue is expensive and impractical for creditors.[45] The availability of multiple venues in which to file a case is often criticized, and has resulted in a recently-introduced bill to limit the practice.

The Bankruptcy Venue Reform Act of 2021 (H.R. 4193), introduced on June 28, 2021, by Reps. Lofgren (D. Calif.) and Buck (R. Colo.) is pending in the U.S. House of Representatives. This is the fifth year in a row with legislation introduced to reform the venue statute for bankruptcy cases.[46] The venue reform bill aims to curtail venue forum shopping by requiring debtors to file in the location of their headquarters (as used in SEC filings) or the location of their principal assets, among other related provisions. The CLLA supports this legislation.

CREDITORS MAY APPEAL, RIGHT?

Creditors objecting to the nonparty release face limited avenues to appeal after plan implementation. Practically speaking, if the objecting creditor loses in the bankruptcy court and the plan is confirmed, the appeal will likely face a

41 *See* Becky Yerak & Soma Biswas, Boy Scouts Draw Plan to Settle with Sex-Abuse Victims, Exit Bankruptcy. Here's What We Know, WSJ PRO BANKRUPTCY (August 27, 2021), available at https://www.wsj.com/articles/the-boy-scouts-bankruptcy-case-what-to-know-11630062000.

42 *Id.* See fn 43, infra.

43 See Amended Disclosure Statement for the Fourth Amended Chapter 11 Plan of Reorganization for Boy Scouts of America and Delaware BSA, LLC, No, 20-10343-LSS, Dkt. No. 5485 (July 2, 2021). To argue urgent acceptance of the plan, debtors raise operating pressures related in-part to the Covid-19 pandemic and that the longer the case goes on, the higher the attorneys' fees and expenses. Id. According to the debtors, professional fees charged to the Boy Scouts, a mission-driven charitable organization, will exceed $155 million by the end of September 2021, with an on-going run rate of $10 million per month. Id. For the releases and channeling injunction, see also the Fourth Amended Chapter 11 Plan of Reorganization for Boy Scouts of America and Delaware BSA, LLC, No. 20-10343-LSS, Dkt. No. 5484 (July 2, 2021). Public access to the bankruptcy court docket and related case information is available at https://cases.omniagentsolutions.com (search Boy Scouts of America for case web page).

44 Adam Levitin, Boy Scouts of America: Venue Demerit Badge, Credit Slips Blog, posted Feb. 21, 2020.

45 *Id.*

46 Congress has introduced legislation to curtail venue shopping in bankruptcy cases in the House or Senate repeatedly in the new millennium. The recent momentum over the last few years reflects efforts by the CLLA, an ad hoc group of nationwide supports from coast to coast, and other supportive organizations such as the National Association of Attorneys' General (NAAG) and United Mine Workers, among many others. NAAG issued a letter signed by 42 state and territory attorneys' general advocating for venue reform. See National Association of Attorneys General, Letter Re: H.R. 4421 – Bankruptcy Venue Reform Act of 2019, dated Feb. 20, 2020, available at https://www.naag.org/press-releases/attorneys-general-support-bankruptcy-venue-reform-act-of-2019/.

This position is consistent with the opposition of some attorneys general to broad nonconsensual releases of state and public entities claims in Purdue Pharma. Maryland and Washington were lead states behind the NAAG letter and oppose the Purdue Pharma plan. See Brian E. Frosh, Maryland Attorney General, Press Release (Sept. 1. 2021) and Bob Ferguson, Washington Attorney General, Press Release (Sept. 1, 2021). The State of Washington immediately filed its notice of appeal of the Purdue Pharma plan following confirmation, 19-23649-rdd, Dkt. No. 3724 (Sept. 1, 2021), fn. 2, infra.

FirstEnergy Solutions is another case that attracted state and federal government opposition to nonconsensual third-party releases in a plan settlement protecting a nondebtor parent company for around $1 billion in consideration. For a brief overview of the release issue, see David A. Beck, A Billion Can't Always Buy You a Third-Party Release, 38 AM. BANKR. INST. J. 26 (Nov. 2019). The plan was confirmed without the third-party release. *Id.*

motion to dismiss based upon another controversial bankruptcy doctrine, equitable mootness. This bankruptcy invention is premised upon the idea that a successful appeal after confirmation would require that the bankruptcy court unwind the whole plan, which is not feasible once parties take action to implement it. Accordingly, even meritorious appeals are cut off if the remedy would "upset the apple cart" because the court "could not put humpty dumpty back together again" after plan implementation.[47] Once an appeal of a confirmation order is dismissed as "equitably moot," the nonconsenting creditor is left without an agreed remedy and with no appellate review.

Along with significant costs incurred by the debtor to advocate for the nonconsensual third-party releases in the plan, resources that arguably would otherwise go to creditor distributions, creditors also face significant costs and obstacles to contest the releases or other aspects of the settlement. These costs are in addition to what has been spent and what is expected to be spent on the merits of the claims. Some creditors will readily accept the plan and releases, while others may do so reluctantly, abandoning the fight only after additional bankruptcy trial practice exhausts time and resources, and tolerance for the process has compelled acquiescence.[48]

WHERE DOES THIS LEAVE MASS TORT CASES IN BANKRUPTCY?

Well-resourced nondebtors pay significant sums into a settlement of an affiliated debtor's bankruptcy case, relying upon the debtor, through its professionals, to gain approval of nondebtor releases, over the objection of creditors. Bankruptcy is a lumbering and expensive process. Many professionals are paid through the estate as a priority expense, reducing monies otherwise available to creditor recoveries. If the court overrules objections to the releases and settlement, creditors are stuck, and lose the right to be heard in any court on the released claims, and often, on the plan itself if they appeal.

This is quid pro quo: in exchange for millions or even billions contributed to the debtor, the court enjoins creditors from any further litigation. The nondebtor buys global peace. Sometimes it doesn't work.[49] More often it does.[50] In *Purdue Pharma*, the bankruptcy court confirmed the plan with modestly narrowed nonconsensual third-party releases after a contested plan confirmation hearing. For those releases, the estate received around $4.5 billion and other benefits for creditors.[51]

Although substantial consideration to the estate should not be the sole objective, it is required by courts and is core to the argument for third-party releases. The argument goes that without these releases, the nondebtors will not fund the settlement and therefore the plan will fail, leaving creditors with a far worse outcome such as years of costly, highly -contested litigation, or even with nothing at all. That the nondebtors will settle in the bankruptcy case suggests they would likely also settle in state court proceedings, or in their own bankruptcy case. However, this reasonable scenario is rarely observed in argument, and the choice presented is between a fight to the bitter end or accepting a "meh, okay" deal now.

CONGRESS TO THE RESCUE, MAYBE?

Given the spotlight on nonconsensual third-party releases, Congress has taken notice. Two bills are pending this term on the Hill. The first, called the SACKLER Act (Stop Shielding Assets from

47 S*ee, e.g., In re UNR Indus., Inc.*, 20 F.3d 766, 768-71 (7th Cir. 1994) (apple cart), *In re Thorpe Insulation Co.*, 677 F.3d 869, 883 (9th Cir. 2012) (same); *In re Pub. Svc. Co. of New Hampshire*, 963 F.2d 469, 475 (1st Cir. 1992) (humpty dumpty); see also *Continental Airlines*, 91 F.3d 553, 566 (3d Cir.1996) (unscrambling eggs). For more recent discussions of the equitable mootness doctrine, see *In re VeroBlue Farms USA, Inc.,* Nos. 19-3413, 19-3487 (8th Cir. Aug. 5, 2021) (remanding for further analysis); *In re Tribune Media Co.*, 799 F.3d 272 (3d Cir. 2015) (granting dismissal on equitable mootness grounds one appeal, remanding on another); *In re One2One Commc'ns, LLC*, No. 13-3410, 2015 WL 4430302 (3d Cir. 2015) (rejecting dismissal); Andrew Scurria, Bankruptcy Appeals are Dismissed too Quickly, Appellate Court Says, WSJ PRO BANKRUPTCY (Aug. 5, 2021). The author was actively on brief in the *Tribune Media* appeals.

48 *See* Brian Mann, 15 States Drop Opposition to Controversial Purdue Pharma OxyContin Bankruptcy, NPR (July 8, 2021), available at https://www.npr.org/2021/07/08/1014043094/fifteen-states-drop-opposition-to-controversial-purdue-pharma-oxycontin-bankrupt.

49 *In FirstEnergy Solutions*, the debtors failed to get past the disclosure statement stage with an overly broad release that failed to satisfy the *Dow Corning* factor test, controlling precedent in the Sixth Circuit. See fn 46, supra. The author contributed to this article and served as counsel to an opponent to the nonconsensual third-party release first proposed by the debtors in their disclosure statement. Bankruptcy Judge Alan Koschik held that FirstEnergy Solutions' plan was patently unconfirmable because it contained a nonconsensual third-party release that could not be approved because it failed to meet all factors under the Dow Corning factor test. Id.

50 *See* Meryl Kornfield, Bankruptcy Judge Approves Purdue Pharma Plan to Resolve Opioid Claims, Giving Sackler Family Civil Immunity, WASH. POST (Sept. 1, 2021), available at https://www.washingtonpost.com/business/2021/09/01/purdue-pharma-bankruptcy-judge-ruling/.

51 *See* fn 2, supra; Jan Hoffman, Purdue Pharma Is Dissolved and Sacklers Pay $4.5 Billion to Settle Opioid Claims, N.Y. TIMES (Sept. 1, 2021), available at https://www.nytimes.com/2021/09/01/health/purdue-sacklers-opioids-settlement.html.

Corporate Known Liability by Eliminating non-debtor Releases Act) (S.2472) is plainly a reaction to the *Purdue Pharma* case and would prohibit the nonconsensual release of claims held by states, municipalities, and other public entities. (The "Sackler" named in the bill refers to the family that owned *Purdue Pharma* during the opioid crisis.) It was introduced in the Senate on July 26, 2021, by Sens. Warren (D-Mass.) and Blumenthal (D-Conn.) and as of September 3, 2021, had no other cosponsors. This bill would amend section 105 to clarify that a court may not "except as provided by section 524(g) of this title, enjoin or release a claim against a non-debtor by a State, municipality, federally recognized Tribe, or the United States," among other related provisions, such as limiting any temporary stay ordered by the court to 90 days.

The other pending bill has been introduced in both chambers and is entitled the Nondebtor Release Prohibition Act of 2021 and is intended to "amend title 11, United States Code, to prohibit nonconsensual release of a nondebtor entity's liability to an entity other than the debtor, and for other purposes." (S.2497, H.R.4777). Introduced on July 28, 2021 by Rep. Nadler (D-NY) in the House and Sen. Warren (D-Mass.) in the Senate, this bill has few other co-sponsors. The Act would bar any nonconsensual third-party releases by proposing a new section 113 titled "Prohibition of nondebtor releases," subject to certain exceptions including §524(g) and consensual releases.[52] The Act also attempts to regulate consensual releases (with new standards for notice and consent), sales and asset dispositions, stays, and appeals, all related to release practices.

Although the legislation may not move quickly or at all this year, Congress also signaled strong interest by scheduling a public hearing; on July 28, 2021, the House Judiciary's Subcommittee on Antitrust, Commercial and Administrative Law held a hearing on Confronting Abuses of the Chapter 11 System, including nonconsensual third-party releases.[53] Witnesses included Connecticut's Attorney General who opposed the *Purdue Pharma* settlement and a former Olympic gymnast, now an attorney, who has opposed the injunctions imposed in the *USA Gymnastics* bankruptcy which protect the U.S. Olympic Committee, a nondebtor, from suit.[54]

The hearing also addressed venue shopping, which as noted above is often related to nonconsensual third-party releases. Professor Adam Levitin of Georgetown Law Center argued against allowing debtors to hand-pick venue to get before a court which is amenable to nonconsensual third-party releases. According to Professor Levitin, by remaining outside bankruptcy themselves and obtaining broad releases in the *Purdue Pharma* case, the Sacklers "will actually emerge from Purdue's bankruptcy richer than they went into it."[55] Addressing the longstanding practice of filing large chapter 11 cases in magnet courts, Professor Levitin revealed that "57% of the large company bankruptcies filed in the country were filed before just three of the nation's 375 bankruptcy judges."[56]

Do practitioner efforts to hand-pick courts (and even judges) favorably disposed to their plan represent zealous advocacy or abuse of the system? By leveraging immense power through bankruptcy (including ready use of injunctions) to forcibly compromise and release claims against nondebtors, the current practice stretches the reach and imagination of bankruptcy law.[57]

52 Senate bill 2497 and House bill 4777 provide that "the court may not – (1) with respect to the liability of an entity other than the debtor or the estate on, or the liability of property of an entity other than the debtor or the estate for, a claim or cause of action of an entity other than the debtor or the estate–(A) approve any provision, in a plan of reorganization or otherwise, for the discharge, release, termination, or modification of such liability; or (B) order the discharge, release, termination, or modification of such liability; or (2) with respect to a claim or cause of action of an entity other than the debtor or the estate against an entity other than the debtor or the estate, or against property of an entity other than the debtor or the estate, enjoin–(A) the commencement or continuation (including the issuance or employment of process) of a judicial, administrative, or other action or proceeding to assert, assess, collect, recover, offset, recoup, or otherwise enforce such claim or cause of action; or (B) any act to assert, assess, collect, recover, offset, recoup, or otherwise enforce such claim or cause of action."

53 *See* Maria Chutchian, Bankruptcy Reform Debate Targets Bad Corporate Actors, Popular Judges, REUTERS (July 28, 2021), available at www.reuters.com/legal/transactional/bankruptcy-reform-debate-targets-bad-corporate-actors-popular-judges-2021.

54 *Id.*

55 *See* Press Release, Professor Adam Levitin to Congress: "Perverse" Bankruptcy Rule Makes Rich Richer, Georgetown Law Center (Aug. 4, 2021), available at www.law.georgetown.edu/news/professor-adam-levitin-to-congress-perverse-bankruptcy-rule-makes-rich-richer.

56 *See* Written Testimony of Adam J. Levitin, Professor of Law, Georgetown University Law Center, Committee on the Judiciary Subcommittee on Antitrust, Commercial, and Administrative Law, U.S. House of Representatives, Oversight of the Bankruptcy Code, Part I: Confronting Abuse of the Chapter 11 System, July 28, 2021.

57 For a discussion of the propriety and constitutionality of bankruptcy courts granting nonconsensual, third-party releases, see Ralph Brubaker, *A Case Study in Federal Bankruptcy Jurisdiction: Core Jurisdiction (or Not) to Approve Non-Debtor "Releases" and Permanent Injunctions in Chapter 11*, 38 BANKRUPTCY LAW LETTER (February 2018).

CONCLUSION

The CLLA is monitoring developments with these bills and debating whether the League should take a formal position on nonconsensual third-party releases, including whether another approach may be a better solution than either pending bill, a narrow ban protecting public entities or a wholesale ban of the practice. The ABI Commission to Study the Reform of Chapter 11, for example, has recommended preserving nonconsensual third-party releases if they pass muster after the Court applies the Master Mortgage factors.[58] This is not the last word on nonconsensual third-party releases and the recent mass tort cases of *Purdue Pharma*, *Boy Scouts*, and *USA Gymnastics* will likely fuel continued debate and inform congressional action.

Some commentators argue that the issue is ripe for resolution by the Supreme Court, which could resolve the circuit court split and provide meaningful guidance.[59] However, for a statute-based practice such as bankruptcy, a legislative fix by Congress seems preferable. By design, Congress is closer to the public policy concerns of balancing the needs of constituents with corporate debtors and owners.

Congress should act. As shown in connection with *Purdue Pharma*, which inspired public protests, trust in the integrity of the bankruptcy system may itself be at risk. ■

58 ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations, pp. 252-56 (2012-2014), available at https://abiworld.app.box.com/s/vvircv5xv83aavl4dp4h.

59 See Hon. Harlin D. Hale, et al., *Set Me Free: Shared Policy Concerns on Nonconsensual Third-Party Releases*, 35 AM. BANKR. INST. J. 26 (Sept. 2016).

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