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SIMMERING ISSUES IN CHAPTER 11:
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Liability Releases for Nondebtor Third Parties After *Purdue Pharma*

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THIRD-PARTY LIABILITY RELEASES AFTER *PURDUE PHARMA*

Harrington v. Purdue Pharma L.P., 144 S.Ct. 2071, 2088 (2024):

"Confining ourselves to the question presented, we hold only that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants."

direct claims by creditors or shareholders against non-debtor third party

- e.g., officers, directors, or other principals
- affiliates, insurers, other creditors
- guarantors

- for direct personal liability
  - e.g., fraud, conspiracy, aiding & abetting, joint tortfeasor
- cause of action does not belong to estate
  - so estate rep/s have no standing/authority to prosecute such third-party claims

    See Caplin v. Marine Midland Grace Tr. Co., 406 U.S. 416 (1972)
  - nor compromise/settle such claims

    See Purdue Pharma, 144 S. Ct. at 2084 & n.3, 2086 direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
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- including claims that individual creditors or shareholders can assert outside bankruptcy
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“Full Payment” Plans

See Purdue Pharma, 144 S. Ct. at 2088:

“Nor do we have occasion today to . . . pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor.”

See generally David R. Kuney, *The Aftermath of* Purdue Pharma*: The Myth of the Full-Pay Plan*, 43 AM. BANKR. INST. J. No. 8, at 12 (Aug. 2024)

Consensual Releases

See Purdue Pharma, 144 S. Ct. at 2088:

"Nothing in what we have said should be construed to call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan; those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here. See, *e.g., In re Specialty Equipment Cos.*, 3 F.3d 1043, 1047 (CA7 1993). Nor do we have occasion today to express a view on what qualifies as a consensual release . . . "

Consensual Releases

- What constitutes sufficient consent?
  - vote in favor of plan?

    Compare, e.g., In re Coram Healthcare Corp., 315 B.R. 321 (Bankr. D. Del. 2004) (yes), *with In re Arrowmill Dev. Corp.*, 211 B.R. 497 (Bankr. D.N.J. 1997) (no).

Consensual Releases

- What constitutes sufficient consent?
  - failure to opt out of release?
    - YES: *See, e.g., In re Robertshaw US Holding Corp.*, 2024 WL 3897812 (Bankr. S.D. Tex. Aug. 16, 2024); *In re Indianapolis Downs, LLC*, 486 B.R. 286 (Bankr. D. Del. 2013)
    - NO: *See, e.g., Patterson v. Mahwah Bergen Retail Grp, Inc.*, 636 B.R. 641 (E.D. Va. 2022)
    - SOMETIMES YES, SOMETIMES NO: *See, e.g., In re Smallhold, Inc.*, 2024 WL 4296938 (Bankr. D. Del. Sept. 25, 2024) (only if creditor also votes)

Consensual Releases

- If failure to opt out of release is consent, what constitutes failure to opt out of release?
  - not signing/checking separate opt-out election

    See, e.g., In re Washington Mutual, Inc., 442 B.R. 314 (Bankr. D. Del. 2011); *In re DBSD N. Am., Inc.*, 419 B.R. 179 (Bankr. S.D.N.Y. 2009); *In re Conseco, Inc.*, 301 B.R. 525 (Bankr. N.D. Ill. 2003)
  - not voting on plan

    See, e.g., In re Emerald Oil, Inc., No. 16-10704 (Bankr. D. Del.); *In re Smallhold, Inc.*, 2024 WL 4296938 (Bankr. D. Del. Sept. 25, 2024)
  - not objecting to plan

    See, e.g., In re Hertz Corp., No. 20-11218 (Bankr. D. Del.)

Consensual Releases

- What constitutes sufficient consent?
  - use of “death trap” to induce “consent” to release by vote in favor of plan?

Temporary Stays

See, e.g., Celotex Corp. v. Edwards, 514 U.S. 300 (1995); *Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648 (1935); *In re Caesars Entertainment Operating Co.*, 808 F.3d 1186 (7th Cir. 2015)

See generally Ralph Brubaker, *Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten* Callaway v. Benton *Case*, 72 AM. BANKR. L.J. 1, 22-47 (1998)

Post-*Purdue* decisions:

In re Parlement Techs., Inc., 661 B.R. 722 (Bankr. D. Del. 2024); *In re Coast to Coast Leasing, LLC*, 661 B.R. 621 (Bankr. N.D. Ill. 2024)

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See, e.g., *In re Munford, Inc.*, 97 F.3d 449 (11th Cir. 1996)

Syllabus

SUPREME COURT OF THE UNITED STATES

Syllabus

HARRINGTON, UNITED STATES TRUSTEE, REGION 2 *v*. PURDUE PHARMA L. P. ET AL.

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 23–124. Argued December 4, 2023—Decided June 27, 2024

Between 1999 and 2019, approximately 247,000 people in the United States died from prescription-opioid overdoses. Respondent Purdue Pharma sits at the center of that crisis. Owned and controlled by the Sackler family, Purdue began marketing OxyContin, an opioid prescription pain reliever, in the mid-1990s. After Purdue earned billions of dollars in sales on the drug, in 2007 one of its affiliates pleaded guilty to a federal felony for misbranding OxyContin as a less-addictive, less-abusable alternative to other pain medications. Thousands of lawsuits followed. Fearful that the litigation would eventually impact them directly, the Sacklers initiated a "milking program," withdrawing from Purdue approximately $11 billion—roughly 75% of the firm's total assets—over the next decade.

Those withdrawals left Purdue in a significantly weakened financial state. And in 2019, Purdue filed for Chapter 11 bankruptcy. During that process, the Sacklers proposed to return approximately $4.3 billion to Purdue's bankruptcy estate. In exchange, the Sackers sought a judicial order releasing the family from all opioid-related claims and enjoining victims from bringing such claims against them in the future. The bankruptcy court approved Purdue's proposed reorganization plan, including its provisions concerning the Sackler discharge. But the district court vacated that decision, holding that nothing in the law authorizes bankruptcy courts to extinguish claims against third parties like the Sacklers, without the claimants' consent. A divided panel of the Second Circuit reversed the district court and revived the bankruptcy court's order approving a modified reorganization plan.

Held: The bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seek to discharge claims against a nondebtor without the consent of affected claimants. Pp. 7–19.

(a) When a debtor files for bankruptcy, it "creates an estate" that includes virtually all the debtor's assets. 11 U. S. C. §541(a). Under Chapter 11, the debtor must develop a reorganization plan governing the distribution of the estate's assets and present it to the bankruptcy court for approval. §§1121, 1123, 1129, 1141. A bankruptcy court's order confirming a reorganization plan "discharges the debtor" of certain pre-petition debts. §1141(d)(1)(A). In this case, the Sacklers have not filed for bankruptcy or placed all their assets on the table for distribution to creditors, yet they seek what essentially amounts to a discharge. No provision of the code authorizes that kind of relief. Pp. 7–17.

(1) Section 1123(b) addresses the kinds of provisions that may be included in a Chapter 11 plan. That section contains five specific paragraphs, followed by a catchall provision. The first five paragraphs all concern the debtor's rights and responsibilities, as well as its relationship with its creditors. The catchall provides that a plan "may" also "include any other appropriate provision not inconsistent with the applicable provisions of this title." All agree that the first five paragraphs do not authorize the Sackler discharge. But, according to the plan proponents and the Second Circuit, paragraph (6) broadly permits any term not expressly forbidden by the code so long as a judge deems it "appropriate." Because provisions like the Sackler discharge are not expressly prohibited, they reason, paragraph (6) necessarily permits them. That is not correct. When faced with a catchall phrase like paragraph (6), courts do not necessarily afford it the broadest possible construction it can bear. *Epic Systems Corp.* v. *Lewis*, 584 U. S. 497, 512. Instead, we generally appreciate that the catchall must be interpreted in light of its surrounding context and read to "embrace only objects similar in nature" to the specific examples preceding it. *Ibid.* Here, each of the preceding paragraphs concerns the rights and responsibilities of the debtor; and they authorize a bankruptcy court to adjust claims without consent only to the extent such claims concern the debtor. While paragraph (6) doubtlessly confers additional authorities on a bankruptcy court, it cannot be read under the canon of *ejusdem generis* to endow a bankruptcy court with the "radically different" power to discharge the debts of a nondebtor without the consent of affected claimants. *Epic Systems Corp.*, 584 U. S., at 513. And while the dissent reaches a contrary conclusion, it does so only by elevating its view of the bankruptcy code's purported purpose over the text's clear focus on the debtor. Pp. 7–13.

(2) The code's statutory scheme further forecloses the Sackler discharge. The code generally reserves discharge for a debtor who places substantially all of their assets on the table. §1141(d)(1)(A); see also §541(a). And, ordinarily, it does not include claims based on "fraud" or those alleging "willful and malicious injury." §§523(a)(2), (4), (6). The Sackler discharge defies these limitations. The Sacklers have not filed for bankruptcy, nor have they placed virtually all their assets on the table for distribution to creditors. Yet, they seek an order discharging a broad sweep of present and future claims against them, including ones for fraud and willful injury. In all of these ways, the Sacklers seek to pay less than the code ordinarily requires and receive more than it normally permits. Contrary to the dissent's suggestion, plan proponents cannot evade these limitations simply by rebranding their discharge a "release." Pp. 13–16.

(3) History offers a final strike against the plan proponents' construction of §1123(b)(6). Pre-code practice, we have said, may sometimes inform the meaning of the code's more "ambiguous" provisions. *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 566 U. S. 639, 649. And every bankruptcy law cited by the parties and their *amici*—from 1800 until the enactment of the present bankruptcy code in 1978—generally reserved the benefits of discharge to the debtor who offered a "fair and full surrender of [its] property." *Sturges* v. *Crowninshield*, 4 Wheat. 122, 176. Had Congress meant to reshape traditional practice so profoundly in the present bankruptcy code, extending to courts the capacious new power the plan proponents claim, one might have expected it to say so expressly "somewhere in the [c]ode itself." *Dewsnup* v. *Timm*, 502 U. S. 410, 420. Pp. 16–17.

(b) In the end, the plan proponents default to policy. The Sacklers, they say, will not return any funds to Purdue's estate unless the bankruptcy court grants them the sweeping nonconsensual release and injunction they seek. Without the Sackler discharge, they predict, victims will be left without any means of recovery. But the U. S. Trustee disagrees. As he tells it, the potentially massive liability the Sacklers face may induce them to negotiate for *consensual* releases on terms more favorable to all the claimants. In addition, the Trustee warns, a ruling for the Sacklers would provide a roadmap for tortfeasors to misuse the bankruptcy system in future cases. While both sides may have their points, this Court is the wrong audience for such policy disputes. Our only proper task is to interpret and apply the law; and nothing in present law authorizes the Sackler discharge. Pp. 17–19.

(c) Today's decision is a narrow one. Nothing in the opinion should be construed to call into question consensual third-party releases offered in connection with a bankruptcy reorganization plan. Nor does the Court express a view on what qualifies as a consensual release or pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor. Additionally, because this case involves only a stayed reorganization plan, the Court does not address whether its reading of the bankruptcy code would justify unwinding reorganization plans that have already become effective and been substantially consummated. Confining ourselves to the question presented, the Court holds only that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants. Because the Second Circuit held otherwise, its judgment is reversed and the case is remanded for further proceedings consistent with this opinion. P. 19.

69 F. 4th 45, reversed and remanded.

GORSUCH, J., delivered the opinion of the Court, in which THOMAS, ALITO, BARRETT, and JACKSON, JJ., joined. KAVANAUGH, J., filed a dissenting opinion, in which ROBERTS, C. J., and SOTOMAYOR and KAGAN, JJ., joined.

SUPREME COURT OF THE UNITED STATES

No. 23–124

WILLIAM K. HARRINGTON, UNITED STATES TRUSTEE, REGION 2, PETITIONER *v.* PURDUE PHARMA L. P., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[June 27, 2024]

JUSTICE GORSUCH delivered the opinion of the Court.

The bankruptcy code contains hundreds of interlocking rules about "'the relations between'" a "'debtor and [its] creditors.'" *Wright* v. *Union Central Life Ins. Co.*, 304 U. S. 502, 513–514 (1938). But beneath that complexity lies a simple bargain: A debtor can win a discharge of its debts if it proceeds with honesty and places virtually all its assets on the table for its creditors. The debtor in this case, Purdue Pharma L. P., filed for bankruptcy after facing a wave of litigation for its role in the opioid epidemic. Purdue's long-time owners, members of the Sackler family, confronted a growing number of suits too. But instead of declaring bankruptcy, they chose a different path. From the court overseeing Purdue's bankruptcy, they sought and won an order extinguishing vast numbers of existing and potential claims against them. They obtained all this without securing the consent of those affected or placing anything approaching their total assets on the table for their creditors. The question we face is whether the bankruptcy code authorizes a court to issue an order like that.

I

A

The opioid epidemic represents "one of the largest public health crises in this nation's history." *In re Purdue Pharma L. P.*, 69 F. 4th 45, 56 (CA2 2023). Between 1999 and 2019, approximately 247,000 people in the United States died from prescription-opioid overdoses. *In re Purdue Pharma L. P.*, 635 B. R. 26, 44 (SDNY 2021). The U. S. Department of Health and Human Services estimates that the opioid epidemic has cost the country between $53 and $72 billion annually. *Ibid.*

Purdue sits at the center of these events. In the mid-1990s, it began marketing OxyContin, an opioid prescription pain reliever. 69 F. 4th, at 56. Because of the addictive quality of opioids, doctors had traditionally reserved their use for cancer patients and those "with chronic diseases." 635 B. R., at 42. But OxyContin, Purdue claimed, had a novel "time-release" formula that greatly diminished the threat of addiction. *Ibid.* On that basis, Purdue marketed OxyContin for use in "'a much broader range'" of applications, including as a "'first-line therapy for the treatment of arthritis.'" *Ibid.*

Purdue was a "'family company,'" owned and controlled by the Sacklers. *Id.*, at 40. Members of the Sackler family served as president and chief executive officer; they dominated the board of directors; and they "were heavily involved" in the firm's marketing strategies. 69 F. 4th, at 86 (Wesley, J., concurring in judgment). They "pushed sales targets," too, and "accompanied sales representatives on 'ride along' visits to health care providers" in an effort to maximize OxyContin sales. 635 B. R., at 50.

Quickly, OxyContin became "'the most prescribed brand-name narcotic medication'" in the United States. *Id.*, at 43. Between 1996 and 2019, "Purdue generated approximately $34 billion in revenue . . . , most of which came from OxyContin sales." *Id.*, at 39. The company's success propelled the Sacklers onto lists "of the top twenty wealthiest families in America," with an estimated net worth of $14 billion. *Id.*, at 40.

Eventually, however, the firm came under scrutiny. In 2007, a Purdue affiliate pleaded guilty to a federal felony for misbranding OxyContin as "'less addictive'" and "'less subject to abuse . . . than other pain medications.'" *Id.*, at 48. Thousands of civil lawsuits followed as individuals, families, and governments within and outside the United States sought damages from Purdue and the Sacklers for injuries allegedly caused by their deceptive marketing practices. 69 F. 4th, at 60.

Appreciating this litigation "would eventually impact them directly," *id.*, at 59, the Sacklers began what one family member described as a "'milking' program," 635 B. R., at 57. In the years before the 2007 plea agreement, Purdue's distributions to the Sacklers represented less than 15% of its annual revenue. *Ibid.* After the plea agreement, the Sacklers began taking as much as 70% of the company's revenue each year. *Ibid.* Between 2008 and 2016, the family's distributions totaled approximately $11 billion, draining Purdue's total assets by 75% and leaving it in "a significantly weakened financial" state. 69 F. 4th, at 59. The Sacklers diverted much of that money to overseas trusts and family-owned companies. 635 B. R., at 71.

B

In 2019, Purdue filed for Chapter 11 bankruptcy. Members of the Sackler family saw in that development an opportunity "to get [their own] goals accomplished." *In re Purdue Pharma L. P.*, No. 19–23649 (Bkrtcy. Ct. SDNY, Aug. 18, 2021), ECF Doc. 3599, p. 35 (testimony of David Sackler). They proposed to return to Purdue's bankruptcy estate $4.325 billion of the $11 billion they had withdrawn from the company in recent years. 69 F. 4th, at 61. But they offered to do so only through payments spread out over a decade. *Id.*, at 60. And, in return, they sought the estate's agreement on, and a judicial order addressing, two matters. First, the Sacklers wanted to extinguish any claims the estate might have against family members, including for fraudulently transferring funds from Purdue in the years preceding its bankruptcy. *In re Purdue Pharma L. P.*, 633 B. R. 53, 83–84 (Bkrtcy. Ct. SDNY 2021). Second, the Sacklers wanted to end the growing number of lawsuits against them brought by opioid victims (the Sackler discharge). *Ibid.*

The Sackler discharge they proposed comprised a release and an injunction. The release sought to void not just current opioid-related claims against the family, but future ones as well. It sought to ban not just claims by creditors participating in the bankruptcy proceeding, but claims by anyone who might otherwise sue Purdue. It sought to extinguish not only claims for negligence, but also claims for fraud and willful misconduct. 1 App. 193. And it proposed to end all these lawsuits without the consent of the opioid victims who brought them. To enforce this release, the Sacklers sought an injunction "forever stay[ing], restrain[ing,] and enjoin[ing]" claims against them. *Id.*, at 279. That injunction would not just prevent suits against the company's officers and directors but would run in favor of hundreds, if not thousands, of Sackler family members and entities under their control. *Id.*, at 117–190.

Purdue agreed to these terms and included them in the reorganization plan it presented to the bankruptcy court for approval. In that plan, Purdue further proposed to reorganize as a "public benefit" company dedicated primarily to opioid education and abatement efforts. 633 B. R., at 74. As for individual victims harmed by the company's products, Purdue offered, with help from the Sacklers' anticipated contribution, to provide payments from a base amount of $3,500 up to a ceiling of $48,000 (for the most dire cases, and all before deductions for attorney's fees and other expenses). See 1 App. 557–559, 573–585; 6 App. in No. 22–110 etc. (CA2), p. 1697. For those receiving more than the base amount, payments would come in installments spread over as many as 10 years. 7 *id.*, at 1805, 1812.

Creditors were polled on the proposed plan. Though most who returned ballots supported it, fewer than 20% of eligible creditors participated. 21 *id.*, at 6253, 6258. Thousands of opioid victims voted against the plan too, and many pleaded with the bankruptcy court not to wipe out their claims against the Sacklers without their consent. 635 B. R., at 35. "Our system of justice," they wrote, "demands that the allegations against the Sackler family be fully and fairly litigated in a public and open trial, that they be judged by an impartial jury, and that they be held accountable to those they have harmed." *In re Purdue Pharma L. P.*, No. 7:21–cv–07532 (SDNY, Oct. 25, 2021), ECF Doc. 94, p. 21 (internal quotation marks omitted). The U. S. Trustee, charged with promoting the integrity of the bankruptcy system for all stakeholders, joined in these objections. So did eight States, the District of Columbia, the city of Seattle, and various Canadian municipalities and Tribes, each of which sought to pursue its own claims against the Sacklers. 635 B. R., at 35.

C

The bankruptcy court rejected the objectors' arguments and entered an order confirming the plan, including its provisions related to the Sackler discharge. 633 B. R., at 95–115. Soon, however, the district court vacated that decision. Nothing in the law, that court held, authorized the bankruptcy court to extinguish claims against the Sacklers without the consent of the opioid victims who brought them. 635 B. R., at 115.

After that setback, plan proponents, including Purdue, members of the Sackler family, and various creditors, appealed to the Second Circuit. While their appeal was pending, they also floated a new proposal. Now, they said, the Sacklers were willing to contribute an additional $1.175 to $1.675 billion to Purdue's estate if the eight objecting States and the District of Columbia would withdraw their objections to the firm's reorganization plan. 69 F. 4th, at 67. The Sacklers' proposed contribution still fell well short of the $11 billion they received from the company between 2008 and 2016. Nor did it begin to reflect the earnings the Sacklers have enjoyed from that sum over time. And the proposed contribution would still come in installments spread over many years. But the new proposal was enough to persuade the States and the District of Columbia to drop their objections to the plan, even as a number of individual victims, the Canadian creditors, and the U. S. Trustee persisted in theirs.

Ultimately, a divided panel of the Second Circuit reversed the district court and revived the bankruptcy court's order approving the estate's (now-modified) reorganization plan. Writing separately, Judge Wesley acknowledged that a bankruptcy court enjoys broad authority to modify debtor-creditor relations. But, he argued, nothing in the bankruptcy code grants a bankruptcy court the "extraordinary" power to release and enjoin claims against a third party without the consent of the affected claimants. *Id.*, at 89 (opinion concurring in judgment). The majority's contrary view, he added, "pin[ned the Second] Circuit firmly on one side of a weighty issue that, for too long, has split the courts of appeals." *Id.*, at 90.

After the Second Circuit ruled, the U. S. Trustee filed an application with this Court to stay its decision. We granted the application and, treating it as a petition for a writ of certiorari, agreed to take this case to resolve the circuit split Judge Wesley highlighted. 600 U. S. ___ (2023).[1]

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[1] For examples of decisions on both sides of the split, compare *In re*

II

The plan proponents and U. S. Trustee agree on certain foundational points. When a debtor files for bankruptcy, it "creates an estate" that includes virtually all the debtor's assets. 11 U. S. C. §541(a). Under Chapter 11, the debtor can work with its creditors to develop a reorganization plan governing the distribution of the estate's assets; it must then present that plan to the bankruptcy court and win its approval. §§1121, 1123, 1129, 1141. Once the bankruptcy court issues an order confirming the plan, that document binds the debtor and its creditors going forward—even those who did not assent to the plan. §1141(a).

Most relevant here, a bankruptcy court's order confirming a plan "discharges the debtor from any debt that arose before the date of such confirmation," except as provided in the plan, the confirmation order, or the code. §1141(d)(1)(A). That discharge not only releases or "void[s] any past or future judgments on the" discharged debt; it also "operat[es] as an injunction . . . prohibit[ing] creditors from attempting to collect or to recover the debt." *Tennessee Student Assistance Corporation* v. *Hood*, 541 U. S. 440, 447 (2004) (citing §§524(a)(1), (2)). Generally, however, a discharge operates only for the benefit of the debtor against its creditors and "does not affect the liability of any other entity." §524(e).

The Sacklers have not filed for bankruptcy and have not placed virtually all their assets on the table for distribution to creditors, yet they seek what essentially amounts to a

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Pacific Lumber Co., 584 F. 3d 229 (CA5 2009); *In re Lowenschuss*, 67 F. 3d 1394 (CA9 1995); *In re Western Real Estate Fund, Inc.*, 922 F. 2d 592 (CA10 1990), with *In re Millennium Lab Holdings II, LLC*, 945 F. 3d 126 (CA3 2019); *In re Seaside Engineering & Surveying, Inc.*, 780 F. 3d 1070 (CA11 2015); *In re Airadigm Communications, Inc.*, 519 F. 3d 640 (CA7 2008); *In re Dow Corning Corp.*, 280 F. 3d 648 (CA6 2002); *In re A. H. Robins Co.*, 880 F. 2d 694 (CA4 1989).

discharge. They hope to win a judicial order releasing pending claims against them brought by opioid victims. They seek an injunction "permanently and forever" foreclosing similar suits in the future. 1 App. 279. And they seek all this without the consent of those affected. The question we face thus boils down to whether a court in bankruptcy may effectively extend to *nondebtors* the benefits of a Chapter 11 discharge usually reserved for *debtors*.

A

For an answer, we turn to §1123. It addresses the "[c]ontents"—or terms—of the bankruptcy reorganization plan a debtor presents and a court approves in Chapter 11 proceedings. Some plan terms are mandatory, §1123(a); others are optional, §1123(b). No one suggests that anything like the Sackler discharge *must* be included in a debtor's reorganization plan. Instead, plan proponents contend, it is a provision a debtor *may* include and a court *may* approve in a reorganization plan.

Section 1123(b) governs that question. It directs that a plan "may":

> "(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;
>
> "(2) . . . provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under [§365];
>
> "(3) provide for—
>
> "(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or
>
> "(B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;
>
> "(4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests;

"(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and

"(6) include any other appropriate provision not inconsistent with the applicable provisions of this title."

We can easily rule out the first five of these paragraphs as potential sources of legal authority for the Sackler discharge. They permit a plan to address claims and property belonging to a debtor or its estate. §§1123(b)(2), (3), (4). They permit a plan to modify the rights of creditors who hold claims against the debtor or its estate. §§1123(b)(1), (5). But nothing in those paragraphs authorizes a plan to extinguish claims against third parties, like the Sacklers, without the consent of the affected claimants, like the opioid victims. If authority for the Sackler discharge can be found anywhere, it must be found in paragraph (6). That is the paragraph on which the Second Circuit primarily rested its decision below, and it is the one on which plan proponents pin their case here.[2]

As the plan proponents see it, paragraph (6) allows a

[2] The Sacklers suggest that, if 11 U. S. C. §1123(b) does not permit a bankruptcy court to release and enjoin claims against a nondebtor without the affected claimants' consent, §105(a) does. See Brief for Mortimer-Side Initial Covered Respondents 19 (Brief for Sackler Family). That provision allows a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the bankruptcy code. §105(a). As the Second Circuit recognized, however, "§105(a) alone cannot justify" the imposition of nonconsensual third-party releases because it serves only to "'carry out'" authorities expressly conferred elsewhere in the code. 69 F. 4th 45, 73 (2023) (quoting §105(a)); see also 2 R. Levin & H. Sommer, Collier on Bankruptcy ¶105.01[1], p. 105–6 (16th ed. 2023). Purdue concedes this point, Brief for Debtor Respondents 19, n. 5 (Brief for Purdue), as do several other plan proponents, see, *e.g.*, Brief for Respondent Ad Hoc Committee 29. Necessarily, then, our focus trains on §1123(b)(6).

debtor to include in its plan, and a court to order, *any* term not "expressly forbid[den]" by the bankruptcy code as long as a bankruptcy judge deems it "appropriate" and consistent with the broad "purpose[s]" of bankruptcy. 69 F. 4th, at 73–74; *post*, at 41–42 (KAVANAUGH, J., dissenting). And because the code does not expressly forbid a nonconsensual nondebtor discharge, the reasoning goes, the bankruptcy court was free to authorize one here after finding it an "appropriate" provision. See Brief for Sackler Family 19–21; Brief for Purdue 20; *post*, at 13–15.

This understanding of the statute faces an immediate obstacle. Paragraph (6) is a catchall phrase tacked on at the end of a long and detailed list of specific directions. When faced with a catchall phrase like that, courts do not necessarily afford it the broadest possible construction it can bear. *Epic Systems Corp.* v. *Lewis*, 584 U. S. 497, 512 (2018). Instead, we generally appreciate that the catchall must be interpreted in light of its surrounding context and read to "embrace only objects similar in nature" to the specific examples preceding it. *Ibid.* (internal quotation marks omitted). So, for example, when a statute sets out a list discussing "cars, trucks, motorcycles, or any other vehicles," we appreciate that the catchall phrase may reach similar landbound vehicles (perhaps including buses and camper vans), but it does not reach dissimilar "vehicles" (such as airplanes and submarines). See *McBoyle* v. *United States*, 283 U. S. 25, 26–27 (1931). This ancient interpretive principle, sometimes called the *ejusdem generis* canon, seeks to afford a statute the scope a reasonable reader would attribute to it.

Viewed with that much in mind, we do not think paragraph (6) affords a bankruptcy court the authority the plan proponents suppose. In some circumstances, it may be difficult to discern what a statute's specific listed items share in common. See A. Scalia & B. Garner, Reading Law 207–

208 (2012). But here an obvious link exists: When Congress authorized "appropriate" plan provisions in paragraph (6), it did so only after enumerating five specific sorts of provisions, all of which concern *the debtor*—its rights and responsibilities, and its relationship with its creditors. Doubtless, paragraph (6) operates to confer additional authorities on a bankruptcy court. See *United States* v. *Energy Resources Co.*, 495 U. S. 545, 549 (1990). But the catchall cannot be fairly read to endow a bankruptcy court with the "radically different" power to discharge the debts of a nondebtor without the consent of affected nondebtor claimants. *Epic Systems Corp.*, 584 U. S., at 513; see also *RadLAX Gateway Hotel, LLC* v. *Amalgamated Bank*, 566 U. S. 639, 645–647 (2012).

The catchall's text underscores the point. Congress could have said in paragraph (6) that "everything not expressly prohibited is permitted." But it didn't. Instead, Congress set out a detailed list of powers, followed by a catchall that it qualified with the term "appropriate." That quintessentially "context dependent" term often draws its meaning from surrounding provisions. *Sossamon* v. *Texas*, 563 U. S. 277, 286 (2011). And we know to look to the statute's preceding specific paragraphs as the relevant "context" here because paragraph (6) tells us so. It permits "any *other* appropriate provision"—that is, "other" than the provisions already discussed in paragraphs (1) through (5). (Emphasis added.) Each of those "other" paragraphs authorizes a bankruptcy court to adjust claims without consent only to the extent such claims concern the debtor. From this, it follows naturally that an "appropriate provision" adopted pursuant to the catchall that purports to extinguish claims without consent should be similarly constrained. See, *e.g.*, *Epic Systems Corp.*, 584 U. S., at 512–513.

For its part, the dissent does not dispute that the *ejusdem generis* canon applies to §1123(b)(6). *Post*, at 33–34; see also Brief for Sackler Family 44; Brief for Purdue 23. But it disagrees with our application of the canon for two reasons. First, the dissent claims, it "is factually incorrect" to suggest that all the provisions of §1123(b) concern the debtor's rights and responsibilities. *Post*, at 35. The dissent points out that a bankruptcy estate may settle creditors' "derivative claims" against nondebtors under paragraph (3). *Post*, at 36. And this "indisputable point," the dissent declares, "defeats the Court's conclusion that §1123(b)'s provisions relate only to the debtor and do not allow releases of claims that victims and creditors hold against nondebtors." *Post*, at 37; see Brief for Purdue 24–25.

But that argument contains a glaring flaw. The dissent neglects *why* a bankruptcy court may resolve derivate claims under paragraph (3): It may because those claims belong to the debtor's estate. See, *e.g.*, *In re Ontos, Inc.*, 478 F. 3d 427, 433 (CA1 2007). In a derivative action, the named plaintiff "is only a nominal plaintiff. The substantive claim belongs to the corporation." 2 J. Macey, Corporation Laws §13.20[D], p. 13–140 (2020–4 Supp.). And no one questions that Purdue may address in its own bankruptcy plan claims "wherever located and by whomever held," §541(a)—including those claims derivatively asserted by another on its behalf, see §1123(b)(3). The problem is, the Sackler discharge is nothing like that. Rather than seek to resolve claims that substantively belong to Purdue, it seeks to extinguish claims against the Sacklers that belong to their victims. And precisely nothing in §1123(b) suggests those claims can be bargained away without the consent of those affected, as if the claims were somehow Purdue's own property.[3]

[3] In an effort to blur this distinction, the dissent points out that the Sackler discharge covers claims for which Purdue's conduct is a "legally relevant factor." *Post*, at 34–35 (quoting 69 F. 4th, at 80). But that does not alter the fact that the Sackler discharge would extinguish *the victims*' claims against *the Sacklers*. Those claims neither belong to Purdue nor are they asserted against Purdue or its estate. The dissent disregards

Having come up short on the text of §1123(b), the dissent pivots to the statute's purpose. *Post*, at 35. As the dissent sees it, our application of the *ejusdem generis* canon should focus less on the provisions preceding the catchall and more on the overall "purpose of bankruptcy law" in solving "collective-action problem[s]." *Post*, at 5, 35–36; see also Brief for Purdue 21. But there is an obvious difficulty with this approach, too. As this Court has long recognized, "[n]o statute pursues a single policy at all costs." *Bartenwerfer* v. *Buckley*, 598 U. S. 69, 81 (2023). Always, the question we face is *how far* Congress has gone in pursuing one policy or another. See *ibid.* So, yes, bankruptcy law may serve to address some collective-action problems, but no one (save perhaps the dissent) thinks it provides a bankruptcy court with a roving commission to resolve all such problems that happen its way, blind to the role other mechanisms (legislation, class actions, multi-district litigation, consensual settlements, among others) play in addressing them. And here, the five paragraphs that precede the catchall tell us that bankruptcy courts may have many powers, including the power to address certain collective-action problems when they implicate the debtor's rights and responsibilities. But those directions also indicate that a bankruptcy court's powers are not limitless and do not endow it with the power to extinguish without their consent claims held by nondebtors (here, the opioid victims) against other nondebtors (here, the Sacklers).[4]

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these elemental distinctions. See, *e.g.*, *post*, at 49 (conflating the estate's power to settle its own fraudulent transfer claims against the Sacklers with the power to extinguish those of the victims against the Sacklers).

[4] The dissent characterizes our analysis of paragraph (6) as "breez[y]," as if the analysis would be correct if only it were belabored. *Post*, at 34. And yet it is the dissent that relegates the text of the relevant statute, §1123(b), to a pair of footnotes bookending a 25-page exposition on collective-action problems and public policy, one that precedes any effort to engage with our statutory analysis. See *post*, at 7, n. 1, 32, n. 5.

B

When resolving a dispute about a statute's meaning, we sometimes look for guidance not just in its immediate terms but in related provisions as well. See, *e.g.*, *Turkiye Halk Bankasi A. S.* v. *United States*, 598 U. S. 264, 275 (2023). Paragraph (6) itself alludes to this fact by instructing that any plan term adopted under its auspices must not be "inconsistent with the applicable provisions of" the bankruptcy code. Following that direction and looking to Chapter 11 more broadly, we find at least three further reasons why §1123(b)(6) cannot bear the interpretation the plan proponents and the dissent would have us give it.

First, consider what is and who can earn a discharge. As we have seen, a discharge releases the debtor from its debts and enjoins future efforts to collect them—even by those who do not assent to the debtor's reorganization plan. §§524(a)(1)–(2), 1129(b)(1), 1141(a). Generally, too, the bankruptcy code reserves this benefit to "the debtor"—the entity that files for bankruptcy. §1141(d)(1)(A); accord, §524(e); see also §§727(a)–(b). The plan proponents and the dissent's reading of §1123(b)(6) would defy these rules by effectively affording to a nondebtor a discharge usually reserved for the debtor alone.

Second, notice how the code constrains the debtor. To win a discharge, again as we have seen, the code generally requires the debtor to come forward with virtually all its assets. §§541(a)(1), 548. Nor is the discharge a debtor receives unbounded. It does not reach claims based on "fraud" or those alleging "willful and malicious injury." §§523(a)(2), (4), (6). And it cannot "affect any right to trial by jury" a creditor may have "with regard to a personal injury or wrongful death tort claim." 28 U. S. C. §1411(a). The plan proponents and the dissent's reading of §1123(b)(6) transgresses all these limits too. The Sacklers have not agreed to place anything approaching their full assets on the table for opioid victims. Yet they seek a judicial order that would extinguish virtually all claims against them for fraud, willful injury, and even wrongful death, all without the consent of those who have brought and seek to bring such claims. In each of these ways, the Sacklers seek to pay less than the code ordinarily requires and receive more than it normally permits.

Finally, there is a notable exception to the code's general rules. For asbestos-related bankruptcies—and only for such bankruptcies—Congress has provided that, "[n]otwithstanding" the usual rule that a debtor's discharge does not affect the liabilities of others on that same debt, §524(e), courts may issue "an injunction . . . bar[ring] any action directed against a third party" under certain statutorily specified circumstances. §524(g)(4)(A)(ii). That the code *does* authorize courts to enjoin claims against third parties without their consent, but does so in only *one* context, makes it all the more unlikely that §1123(b)(6) is best read to afford courts that same authority in *every* context. See, *e.g.*, *Bittner* v. *United States*, 598 U. S. 85, 94 (2023); *AMG Capital Management, LLC* v. *FTC*, 593 U. S. 67, 77 (2021).[5]

How do the plan proponents and the dissent reply to all this? Essentially, they ask us to look the other way. Whatever limits the code imposes on debtors and discharges mean nothing, they say, because the Sacklers seek a "release," not a "discharge." See, *e.g.*, *post*, at 46–48. But word

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[5] The dissent claims that, in making this observation, we defy §524(g)'s directive that "[n]othing in [it], or in the amendments made by [its addition to the bankruptcy code], shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization." 108 Stat. 4117, note following 11 U. S. C. §524; see *post*, at 44–45. That charge misunderstands the point. We do not read §524(g) to "impair" or "modify" authority previously available to courts in bankruptcy. To the contrary, we simply understand §524(g) to illustrate how Congress might proceed if it intended to confer upon bankruptcy courts a novel and extraordinary power to extinguish claims against third parties without claimants' consent. See *Czyzewski* v. *Jevic Holding Corp.*, 580 U. S. 451, 465 (2017).

games cannot obscure the underlying reality. Once more, the Sacklers seek greater relief than a bankruptcy discharge normally affords, for they hope to extinguish even claims for wrongful death and fraud, and they seek to do so without putting anything close to all their assets on the table. Nor is what the Sacklers seek a traditional release, for they hope to have a court extinguish claims of opioid victims without their consent. See, *e.g.*, J. Macey, Corporate Governance: Promises Kept, Promises Broken 152 (2008) ("settlements are, by definition, consensual"); accord, *Firefighters* v. *Cleveland*, 478 U. S. 501, 529 (1986). Describe the relief the Sacklers seek how you will, nothing in the bankruptcy code contemplates (much less authorizes) it.

C

If text and context supply two strikes against the plan proponents and the dissent's construction of §1123(b)(6), history offers a third. When Congress enacted the present bankruptcy code in 1978, it did "not write 'on a clean slate.'" *Hall* v. *United States*, 566 U. S. 506, 523 (2012) (quoting *Dewsnup* v. *Timm*, 502 U. S. 410, 419 (1992)). Recognizing as much, this Court has said that pre-code practice may sometimes inform our interpretation of the code's more "ambiguous" provisions. *RadLAX Gateway Hotel*, 566 U. S., at 649.

While we discern no ambiguity in §1123(b)(6) for the reasons explored above, historical practice confirms the lesson we take from it. Every bankruptcy law the parties and their *amici* have pointed us to, from 1800 until 1978, generally reserved the benefits of discharge to the debtor who offered a "fair and full surrender of [its] property." *Sturges* v. *Crowninshield*, 4 Wheat. 122, 176 (1819); accord, *Central Va. Community College* v. *Katz*, 546 U. S. 356, 363–364 (2006); see, *e.g.*, Bankruptcy Act of 1800, §5, 2 Stat. 23 (repealed 1803); Act of Aug. 19, 1841, §3, 5 Stat. 442–443 (repealed 1843); Act of Mar. 2, 1867, §§11, 29, 14 Stat. 521, 531–532 (repealed 1878); Bankruptcy Act of 1898, §§7, 14, 30 Stat. 548, 550 (repealed 1978). No one has directed us to a statute or case suggesting American courts in the past enjoyed the power in bankruptcy to discharge claims brought by nondebtors against other nondebtors, all without the consent of those affected. Surely, if Congress had meant to reshape traditional practice so profoundly in the present bankruptcy code, extending to courts the capacious new power the plan proponents claim, one might have expected it to say so expressly "somewhere in the [c]ode itself." *Dewsnup*, 502 U. S., at 420.[6]

III

Faced with so many marks against its interpretation of the law, plan proponents and the dissent resort to a policy argument. The Sacklers, they remind us, have signaled that they will not return any funds to Purdue's estate unless the bankruptcy court grants them the sweeping nonconsensual release and injunction they seek. Absent these concessions, plan proponents and the dissent emphatically predict, "there will be no viable path" for victims to recover even $3,500 each. Tr. of Oral Arg. 100; Brief for Sackler Family 27; see Brief for Respondent Official Committee of Unsecured Creditors of Purdue Pharma L. P. et al. 45–46; *post*, at 4, 21–28, 52–54.

The U. S. Trustee disputes that assessment. Yes, he says, reversing the Second Circuit may cause Purdue's current reorganization plan to unravel. But that would also

[6] The dissent declares pre-code practice irrelevant to the task at hand and insists the power to order nonconsensual releases has been settled by "decades" of bankruptcy court practice. *Post*, at 3, 5, 8, 11, 50–51. But in resisting the notion that pre-code practice may inform our work, the dissent defies our precedents. And in appealing to "decades" of lower court practice, the dissent seems to forget why we took this case in the first place: to resolve a longstanding and deeply entrenched disagreement between lower courts over the legality of nonconsensual third-party releases. See n. 1, *supra*.

mean the Sacklers would face lawsuits by individual victims, States, other governmental entities, and perhaps even fraudulent-transfer claims from the bankruptcy estate. So much legal exposure, the Trustee asserts, may induce the Sacklers to negotiate *consensual* releases on terms more favorable to opioid victims. Brief for Petitioner 47–48. The Sacklers may "want global peace," the Trustee acknowledges, but that doesn't "mea[n] that they wouldn't pay a lot for 97.5 percent peace." Tr. of Oral Arg. 26. After all, the Trustee reminds us, during the appeal in this very case, the Sacklers agreed to increase their contribution by more than $1 billion in order to secure the consent of the eight objecting States. If past is prologue, the Trustee says, there may be a better deal on the horizon.[7]

Even putting that aside, the Trustee urges us to consider the ramifications of this case for others. Nonconsensual third-party releases, he observes, allow tortfeasors to win immunity from the claims of their victims, including for claims (like wrongful death and fraud) they could not discharge in bankruptcy, and do so without placing anything approaching all of their assets on the table. Endorsing that maneuver, the Trustee says, would provide a "roadmap for corporations and wealthy individuals to misuse the bankruptcy system" in future cases "to avoid mass-tort liability." Brief for Petitioner 44–45.

Both sides of this policy debate may have their points.

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[7] The parties likewise spar over whether, absent the Sacklers' discharge, the family could deplete the estate by asserting indemnification claims against the company. Plan proponents and the dissent point to a 2004 agreement that commits Purdue to cover certain liability and legal expenses the Sacklers incur. Brief for Purdue 10; *post*, at 21–24. But here again, the Trustee sees things differently. He underscores the plan proponents' concession that the 2004 agreement "does not apply if a court determines the Sacklers 'did not act in good faith.'" Reply Brief 16. And, he adds, bankruptcy courts have a variety of statutory tools at their disposal to disallow or equitably subordinate any potential indemnification claims the Sacklers might pursue. *Ibid.* (citing §§502(e)(1)(B), 510(c)(1)).

But, in the end, we are the wrong audience for them. As the people's elected representatives, Members of Congress enjoy the power, consistent with the Constitution, to make policy judgments about the proper scope of a bankruptcy discharge. Someday, Congress may choose to add to the bankruptcy code special rules for opioid-related bankruptcies as it has for asbestos-related cases. Or it may choose not to do so. Either way, if a policy decision like that is to be made, it is for Congress to make. Despite the misimpression left by today's dissent, our only proper task is to interpret and apply the law as we find it; and nothing in present law authorizes the Sackler discharge.

IV

As important as the question we decide today are ones we do not. Nothing in what we have said should be construed to call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan; those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here. See, *e.g.*, *In re Specialty Equipment Cos.*, 3 F. 3d 1043, 1047 (CA7 1993). Nor do we have occasion today to express a view on what qualifies as a consensual release or pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor. Additionally, because this case involves only a stayed reorganization plan, we do not address whether our reading of the bankruptcy code would justify unwinding reorganization plans that have already become effective and been substantially consummated. Confining ourselves to the question presented, we hold only that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants. Because the Second Circuit ruled otherwise, its judgment is reversed and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

SUPREME COURT OF THE UNITED STATES

No. 23–124

WILLIAM K. HARRINGTON, UNITED STATES TRUSTEE, REGION 2, PETITIONER *v.* PURDUE PHARMA L.P., ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

[June 27, 2024]

JUSTICE KAVANAUGH, with whom THE CHIEF JUSTICE, JUSTICE SOTOMAYOR, and JUSTICE KAGAN join, dissenting.

Today's decision is wrong on the law and devastating for more than 100,000 opioid victims and their families. The Court's decision rewrites the text of the U. S. Bankruptcy Code and restricts the long-established authority of bankruptcy courts to fashion fair and equitable relief for mass-tort victims. As a result, opioid victims are now deprived of the substantial monetary recovery that they long fought for and finally secured after years of litigation.

Bankruptcy seeks to solve a collective-action problem and prevent a race to the courthouse by individual creditors who, if successful, could obtain all of a company's assets, leaving nothing for all the other creditors. The bankruptcy system works to preserve a bankrupt company's limited assets and to then fairly and equitably distribute those assets among the creditors—and in mass-tort bankruptcies, among the victims. To do so, the Bankruptcy Code vests bankruptcy courts with broad discretion to approve "appropriate" plan provisions. 11 U. S. C. §1123(b)(6).

In this mass-tort bankruptcy case, the Bankruptcy Court exercised that discretion appropriately—indeed, admirably. It approved a bankruptcy reorganization plan for Purdue Pharma that built up the estate to approximately $7 billion by securing a $5.5 to $6 billion settlement payment from the Sacklers, who were officers and directors of Purdue. The plan then guaranteed substantial and equitable compensation to Purdue's many victims and creditors, including more than 100,000 individual opioid victims. The plan also provided significant funding for thousands of state and local governments to prevent and treat opioid addiction.

The plan was a shining example of the bankruptcy system at work. Not surprisingly, therefore, virtually all of the opioid victims and creditors in this case fervently support approval of Purdue's bankruptcy reorganization plan. And all 50 state Attorneys General have signed on to the plan—a rare consensus. The only relevant exceptions to the nearly universal desire for plan approval are a small group of Canadian creditors and one lone individual.

But the Court now throws out the plan—and in doing so, categorically prohibits non-debtor releases, which have long been a critical tool for bankruptcy courts to manage mass-tort bankruptcies like this one. The Court's decision finds no mooring in the Bankruptcy Code. Under the Code, all agree that a bankruptcy plan can nonconsensually release victims' and creditors' claims *against a bankrupt company*—here, against Purdue. Yet the Court today says that a plan can *never* release victims' and creditors' claims *against non-debtor officers and directors of the company*—here, against the Sacklers.

That is true, the Court says, even when (as here) those non-debtor releases are necessary to facilitate a fair settlement with the officers and directors and produce a significantly larger bankruptcy estate that can be fairly and equitably distributed among the victims and creditors. And that is true, the Court also says, even when (as here) those officers and directors are indemnified by the company. When officers and directors are indemnified by the company, a victim's or creditor's claim against the non-debtors "is, in essence, a suit against the debtor" that could "deplete the assets of the estate" for the benefit of only a few, just like a claim against the company itself. *In re Purdue Pharma L. P.*, 69 F. 4th 45, 78 (CA2 2023) (quotation marks omitted).

It therefore makes little legal, practical, or economic sense to say, as the Court does, that the victims' and creditors' claims against the debtor can be released, but that it would be categorically "inappropriate" to release their identical claims against non-debtors even when they are indemnified or when the release generates a significant settlement payment by the non-debtor to the estate.

For decades, bankruptcy courts and courts of appeals have determined that non-debtor releases can be appropriate and essential in mass-tort cases like this one. Non-debtor releases have enabled substantial and equitable relief to victims in cases ranging from asbestos, Dalkon Shield, and Dow Corning silicone breast implants to the Catholic Church and the Boy Scouts. As leading scholars on bankruptcy explain, "the bankruptcy community has recognized the resolution of mass tort claims as a widely accepted core function of bankruptcy courts for decades"—and they emphasize that a "key feature in every mass tort bankruptcy" has been the non-debtor release. A. Casey & J. Macey, In Defense of Chapter 11 for Mass Torts, 90 U. Chi. L. Rev. 973, 974, 977 (2023).

No longer.

Given the broad statutory text—"appropriate"—and the history of bankruptcy practice approving non-debtor releases in mass-tort bankruptcies, there is no good reason for the debilitating effects that the decision today imposes on the opioid victims in this case and on the bankruptcy system at large. To be sure, many Americans have deep hostility toward the Sacklers. But allowing that animosity to infect this bankruptcy case is entirely misdirected and counterproductive, and just piles even more injury onto the opioid victims. And no one can have more hostility toward the Sacklers and a greater desire to go after the Sacklers' assets than the opioid victims themselves. Yet the victims unequivocally seek approval *of this plan*.

With the current plan now gone and non-debtor releases categorically prohibited, the consequences will be severe, as the victims and creditors forcefully explained. Without releases, there will be no $5.5 to $6 billion settlement payment to the estate, and "there will be no viable path to any victim recovery." Tr. of Oral Arg. 100. And without the plan's substantial funding to prevent and treat opioid addiction, the victims and creditors bluntly described further repercussions: "more people will die without this Plan." Brief for Respondent Official Committee of Unsecured Creditors of Purdue Pharma L. P. et al. 55.

In short: Despite the broad term "appropriate" in the statutory text, despite the longstanding precedents approving mass-tort bankruptcy plans with non-debtor releases like these, despite 50 state Attorneys General signing on, and despite the pleas of the opioid victims, today's decision creates a new atextual restriction on the authority of bankruptcy courts to approve appropriate plan provisions. The opioid victims and their families are deprived of their hard-won relief. And the communities devastated by the opioid crisis are deprived of the funding needed to help prevent and treat opioid addiction. As a result of the Court's decision, each victim and creditor receives the essential equivalent of a lottery ticket for a possible future recovery for (at most) a few of them. And as the Bankruptcy Court explained, without the non-debtor releases, there is no good reason to believe that any of the victims or state or local governments will ever recover anything. I respectfully but emphatically dissent.

I

To map out this dissent for the reader: Part I (pages 5 to 18) discusses why non-debtor releases are often appropriate and essential, particularly in mass-tort bankruptcies. Part II (pages 18 to 31) explains why non-debtor releases were appropriate and essential in the Purdue bankruptcy. Part III (pages 31 to 52) engages the Court's contrary arguments and why I respectfully disagree with those arguments. Part IV (pages 52 to 54) sums up.

Throughout this opinion, keep in mind the goal of bankruptcy. The bankruptcy system is designed to preserve the debtor's estate so as to ensure fair and equitable recovery for creditors. Bankruptcy courts achieve that overarching objective by, among other things, releasing claims that otherwise could deplete the estate for the benefit of only a few and leave all the other creditors with nothing. And as courts have recognized for decades, especially in mass-tort cases, non-debtor releases are not merely "appropriate," but can be absolutely critical to achieving the goal of bankruptcy—fair and equitable recovery for victims and creditors.

A

Article I, §8, of the Constitution affords Congress power to establish "uniform Laws on the subject of Bankruptcies throughout the United States" and to "make all Laws which shall be necessary and proper for carrying into Execution" that power.

Early in the Nation's history, Congress established the bankruptcy system. In 1978, Congress significantly revamped and reenacted the Bankruptcy Code in its current form. Bankruptcy Code of 1978, 92 Stat. 2549.

The purpose of bankruptcy law is to address the collective-action problem that a bankruptcy poses. T. Jackson, The Logic and Limits of Bankruptcy Law 12–13 (1986). When a company's liabilities exceed its ability to pay creditors, every creditor has an incentive to maximize its own recovery before other creditors deplete the pot. Without a mandatory collective system, the creditors would race to the courthouse to recover first. One or a few successful creditors could then recover substantial funds, deplete the assets, and drive the company under—leaving other creditors with nothing. See *id*., at 7–19; D. Baird, A World Without Bankruptcy, 50 Law & Contemp. Prob. 173, 183–184 (1987); T. Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain, 91 Yale L. J. 857, 860–868 (1982).

Bankruptcy creates a way for creditors to "act as one, by imposing a *collective* and *compulsory* proceeding on them." Jackson, Logic and Limits of Bankruptcy Law, at 13. One of the goals of Chapter 11 of the Bankruptcy Code in particular is to fairly distribute estate assets among creditors "in order to prevent a race to the courthouse to dismember the debtor." 7 Collier on Bankruptcy ¶1100.01, p. 1100–3 (R. Levin & H. Sommer eds., 16th ed. 2023). Chapter 11 is aimed at preserving an estate's value for distribution to creditors in the face of that collective-action problem.

The basic Chapter 11 case runs as follows. After the debtor files for bankruptcy under Chapter 11, the debtor's property becomes property of the bankruptcy estate. 11 U. S. C. §541. Any litigation that might interfere with the property of the estate is subject to an automatic stay, thus preventing creditors from skipping the line by litigating in a separate forum against the debtor while the bankruptcy is ongoing. §362.

With litigation paused, the parties craft a plan of reorganization for the debtor. The Code grants the bankruptcy court sweeping powers to reorganize the debtor company and ensure fair and equitable recovery for the creditors. For example, the plan may authorize selling or retaining the company's property; merging or consolidating the company; or amending the company's charter. §1123(a)(5). The subsection at issue here, §1123(b), also authorizes many other kinds of provisions that bankruptcy plans may include.[1] Most relevant for this case, as I will explain, the reorganization plan may impair and release "any class of claims" that creditors hold against the debtor. §1123(b)(1). The plan may also settle and release "any claim or interest" that the debtor company holds against non-debtors. §1123(b)(3). And the plan may include "any other appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code. §1123(b)(6).

To address any collective-action or holdout problem, the bankruptcy court has the power to approve a reorganization plan even without the consent of every creditor. If creditors holding more than one-half in number (and at least two-thirds in amount) of the claims in every class accept the plan, the court can confirm the plan. §§1126(c), 1129(a)(8)(A). A plan is "said to be confirmed consensually

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[1] The full text of §1123(b) provides that "a plan may—

"(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;

"(2) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

"(3) provide for—

"(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or

"(B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;

"(4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests;

"(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and

"(6) include any other appropriate provision not inconsistent with the applicable provisions of this title."

if all classes of creditors vote in favor, even if some classes have dissenting creditors." 7 Collier, Bankruptcy ¶1129.01, at 1129–13. That the bankruptcy system considers a plan with majority (even if not unanimous) support to be "consensual" underscores that the bankruptcy system is designed to benefit creditors collectively and prevent holdout problems.

Confirmation of the plan "generally discharges the debtor from all debts that arose before confirmation." *Id.*, ¶1100.09[2][f], at 1100–42 (citing §1141(d)). And all creditors are bound by the plan's distribution, even if some creditors are not happy and oppose the plan. *Ibid.*

B

This is a mass-tort bankruptcy case. Mass-tort cases present the same collective-action problem that bankruptcy was designed to address. "Without a mandatory rule that consolidates claims in a single tribunal, tort claimants would rationally enter a race to the courthouse." A. Casey & J. Macey, In Defense of Chapter 11 for Mass Torts, 90 U. Chi. L. Rev. 973, 997 (2023). And the "plaintiffs who bring successful suits earlier are likely to drain the firm's resources, while inconsistent judgments could result in inequitable payouts even among plaintiffs who ultimately do collect." *Id.*, at 994.

For many decades now, bankruptcy law has stepped in as a coordinating tribunal in significant mass-tort cases. When a company that is liable for mass torts files for bankruptcy, the bankruptcy system enables (and requires) the mass-tort victims who are seeking relief from the bankrupt company to work together to reach a fair and equitable distribution of the company's assets.

In many cases, there is no workable alternative other than bankruptcy for achieving fair and equitable recovery for mass-tort victims. "Outside of bankruptcy," victims face "significant administrative costs" of multi-district litigation, "which has limited coordination mechanisms and no tools for binding future claimants." *Id*., at 1005. And multi-district litigation cannot "solve the collective action problem because dissenting claimants can opt out of settlements even when super majorities favor them." *Ibid*.

Bankruptcy, on the other hand, reduces administrative costs and allows all of the affected parties to come together, pause litigation elsewhere, invoke procedural safeguards including discovery, and reach a collective resolution that considers both current and future victims. Cf. Federal Judicial Center, E. Gibson, Case Studies of Mass Tort Limited Fund Class Action Settlements & Bankruptcy Reorganizations 6 (2000) ("bankruptcy reorganizations provide an inherently fairer method of resolving mass tort claims" than alternative of class-action settlements).

In some cases—including mass-tort cases—it is not only the debtor company, but rather another closely related person or entity such as officers and directors (non-debtors), who may hold valuable assets and also be potentially liable for the company's wrongdoing.

But it may be uncertain whether the victims can recover in tort suits against the non-debtors due to legal hurdles or difficulty reaching the non-debtors' assets. In those cases, a settlement may be reached: In exchange for being released from potential liability for any wrongdoing, the non-debtor must make substantial payments to the company's bankruptcy estate in order to compensate victims. As long as the settlement is fair, the non-debtor's settlement payment will benefit victims "by enlarging the pie of recoverable funds" in the bankruptcy estate. Casey & Macey, 90 U. Chi. L. Rev., at 1001. And it will reduce administrative costs, because the victims' claims against both the debtor and the non-debtor may be resolved "at the same time and in the same tribunal." *Id*., at 1002.

The non-debtor's settlement payment into the estate can also solve a collective-action problem. Bringing the nondebtor's assets into the bankruptcy estate enables those assets to be distributed fairly and equitably among victims, rather than swallowed up by the first victim to successfully sue the non-debtor. *Id.*, at 1002–1003.

A separate collective-action problem can arise when the insolvent company's officers and directors are indemnified by the company for liability arising out of their job duties. In such cases, "a suit against the non-debtor is, in essence, a suit against the debtor." *In re Purdue Pharma L. P.*, 69 F. 4th 45, 78 (CA2 2023) (quotation marks omitted). If not barred from doing so, the creditors could race to the courthouse against the indemnified officers and directors for basically the same claims that they hold against the debtor company. If successful, such suits would deplete the company's assets because a judgment against the indemnified officers and directors would likely come out of the debtor company's assets.

Another similar collective-action problem can involve liability insurance, a kind of indemnification relationship where the insurer is on the hook for tort victims' claims against the debtor company. See B. Zaretsky, Insurance Proceeds in Bankruptcy, 55 Brooklyn L. Rev. 373, 375–376 (1989). The insurance assets—meaning assets to the limits of the debtor's insurance coverage—are usually a key asset for the bankruptcy estate to compensate victims. But tort victims also "may have direct action rights against the insurance carrier, even, in some cases, bypassing the debtor-insured." 5 Collier, Bankruptcy ¶541.10[3], at 541–60. If victims brought their claims directly against the insurer for the same claims that they hold against the estate, one group of victims could obtain from the insurer the full amount of the debtor's coverage. That would obviously prevent the insurance money from being used as part of the bankruptcy estate. See Zaretsky, 55 Brooklyn L. Rev., at 376–377, 394–395.

To address those various collective-action problems, bankruptcy courts have long found non-debtor releases to be appropriate in certain complex bankruptcy cases, especially in mass-tort bankruptcies. Indeed, that is precisely why non-debtor releases emerged in asbestos mass-tort bankruptcies in the 1980s. See *id.*, at 405–414; Casey & Macey, 90 U. Chi. L. Rev., at 998–999; see, *e.g.*, *MacArthur Co.* v. *Johns-Manville Corp.*, 837 F. 2d 89 (CA2 1988). And that is precisely why non-debtor releases have become such a well-established tool in mass-tort bankruptcies in the decades since.

For example, after A. H. Robins declared bankruptcy in 1985 in the face of massive tort liability for injuries from its defective intrauterine device, the Dalkon Shield, nearly 200,000 victims filed proof of claims. *In re A. H. Robins Co.*, 88 B. R. 742, 743–744, 747 (ED Va. 1988), aff'd, 880 F. 2d 694 (CA4 1989). A plan provision releasing the company's directors and insurance company ensured that the estate would not be depleted through indemnity or contribution claims, or claims brought directly against the directors or insurer. 88 B. R., at 751; 880 F. 2d, at 700–702. Preventing the victims from engaging in "piecemeal litigation" against the non-debtor directors and insurance company was the only way to ensure "equality of treatment of similarly situated creditors." 88 B. R., at 751. Therefore, the Bankruptcy Court found (and the Fourth Circuit agreed) that the release was "necessary and essential" to the bankruptcy's success. *Ibid.*; see 880 F. 2d, at 701–702. The plan ultimately provided for the victims to recover in full, and they overwhelmingly approved the plan. *Id.*, at 700–701.

A non-debtor release provision was similarly essential to resolve hundreds of thousands of victims' tort claims against Dow Corning Corporation, which declared bankruptcy in 1995 in the face of liability for its defective silicone breast implants. See *In re Dow Corning Corp.*, 287

B. R. 396, 397 (ED Mich. 2002). The non-debtor release provision prevented the victims from suing Dow Corning's insurers and shareholders for their tort claims—which would have depleted Dow Corning's shared insurance assets and other estate assets. *Id.*, at 402–403, 406–408. The non-debtor release provision was "essential" to the bankruptcy reorganization because the reorganization hinged "on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor." *In re Dow Corning Corp.*, 280 F. 3d 648, 658 (CA6 2002); 287 B. R., at 410–413.

The need for such a tool to deal with complex bankruptcy cases has not gone away. Far from it. Indeed, without the option of bankruptcy with non-debtor releases, "tort victims in several recent high-profile cases would have received less compensation; the compensation would have been unfairly distributed; and the administrative costs of resolving their claims would have been higher." Casey & Macey, 90 U. Chi. L. Rev., at 979; see also Brief for Law Professors in Support of Respondents as *Amici Curiae* 21–25; Brief for Certain Former Commissioners of the American Bankruptcy Institute's Commission To Study the Reform of Chapter 11 as *Amici Curiae* 9–11; Brief for Association of the Bar of the City of New York as *Amicus Curiae* 9, 11–15.

Consider two recent examples that ensured recovery for the victims of torts committed by the Boy Scouts of America and by several dioceses of the Catholic Church. In both cases, a national or regional organization was the debtor in the bankruptcy. But that organization shared its liability and its insurance policy with numerous other legally separate and autonomous local entities. Without a coordinating mechanism, a victim's (or group of victims') recovery against one local entity could have eaten up all of the shared insurance assets, leaving all of the other victims with nothing. Brief for Boy Scouts of America as *Amicus*

Curiae 9–14, 17–19; Brief for U. S. Conference of Catholic Bishops as *Amicus Curiae* 9–22.

Bankruptcy provided a forum to coordinate liability and insurance assets. A non-debtor release provision prevented victims from litigating outside of the bankruptcy plan's procedures. And the provision therefore prevented one victim or group of victims from obtaining all of the insurance funds before other victims recovered. As a result, in each case, the local entities were able to pool their resources to create a substantial fund in a single bankruptcy estate to compensate victims substantially and fairly. Brief for Boy Scouts of America as *Amicus Curiae* 11–12, 20–21; Brief for Ad Hoc Group of Local Councils of the Boy Scouts of America as *Amicus Curiae* 5–6; Brief for U. S. Conference of Catholic Bishops as *Amicus Curiae* 15–16.

As those examples show, in some cases where various closely related but distinct parties share liability or share assets (or both), bankruptcy "provides the *only* forum in the U. S. legal system where a unified and complete resolution of mass-tort cases can reliably occur in a manner that results in a fair recovery and distribution for all claimants." Brief for Association of the Bar of the City of New York as *Amicus Curiae* 15. And the bankruptcy system could not do so without non-debtor releases.

C

The Bankruptcy Code gives bankruptcy courts authority to approve non-debtor releases to solve the complex collective-action problems that such cases present. As noted above, a Chapter 11 reorganization plan may release creditor claims against debtors. §1123(b)(1). And a plan may settle and release debtor claims against non-debtors. §1123(b)(3).

In addition, the plan may also include "any other appropriate provision not inconsistent with the applicable provisions of" the Code. §1123(b)(6). Section 1123(b)(6) provides ample flexibility for the reorganization plan to settle and release creditor claims against non-debtors who are closely related to the debtor. For example, officers and directors may be indemnified by the debtor company; in those cases, creditor claims against indemnified non-debtors are essentially the same as creditor claims against the debtor business itself. Or the non-debtors may reach a settlement with the victims and creditors where the non-debtors pay a settlement amount to the estate, which in some cases may be the only way to ensure fair and equitable recovery for the victims and creditors. The non-debtor releases—just like debtor releases under §1123(b)(1) and non-debtor releases under §1123(b)(3)—can be essential to preserve and increase the estate's assets and can be essential to ensure fair and equitable victim and creditor recovery.

The key statutory term in §1123(b)(6) is "appropriate." As this Court has often said, "appropriate" is a "broad and all-encompassing term that naturally and traditionally includes consideration of all the relevant factors." *Michigan* v. *EPA*, 576 U. S. 743, 752 (2015) (quotation marks omitted). Because determining propriety requires exercising judgment, the inquiry must include a degree of "flexibility." *Ibid.* The Court has explained on numerous occasions that the "ordinary meaning" of a statute authorizing appropriate relief "confers broad discretion" on a court. *School Comm. of Burlington* v. *Department of Ed. of Mass.*, 471 U. S. 359, 369 (1985); see also, *e.g.*, *Sheet Metal Workers* v. *EEOC*, 478 U. S. 421, 446 (1986) (plurality opinion) (Title VII "vest[s] district courts with broad discretion to award 'appropriate' equitable relief"); *Cooter & Gell* v. *Hartmarx Corp.*, 496 U. S. 384, 400 (1990) ("In directing the district court to impose an 'appropriate' sanction, Rule 11 itself indicates that the district court is empowered to exercise its discretion"). Because the "language is open-ended on its face," whether a provision is "appropriate is inherently context dependent." *Tanzin* v. *Tanvir*, 592 U. S. 43, 49 (2020) (quotation marks omitted).

By allowing "any other appropriate provision," §1123(b)(6) empowers a bankruptcy court to exercise reasonable discretion. That §1123 confers broad discretion makes eminent sense, given "the policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code." *NLRB* v. *Bildisco & Bildisco*, 465 U. S. 513, 525 (1984). Such flexibility is important to achieve Chapter 11's ever-elusive goal of ensuring fair and equitable recovery to creditors. See §§1129(a)(7), (b)(1).

The catchall authority in Chapter 11 therefore empowers a bankruptcy court to exercise its discretion to deal with complex scenarios, like the collective-action problems that plague mass-tort bankruptcies. Non-debtor releases are often appropriate—indeed are essential—in such circumstances.

And courts have therefore long found non-debtor releases to be appropriate in certain narrow circumstances under §1123(b)(6). Indeed, courts have been approving such non-debtor releases almost as long as the current Bankruptcy Code has existed since its enactment in 1978. See, *e.g.*, *In re Johns-Manville Corp.*, 68 B. R. 618, 624–626 (Bkrtcy. Ct. SDNY 1986), aff'd, 837 F. 2d, at 90; *A. H. Robins Co.*, 88 B. R., at 751, aff'd, 880 F. 2d, at 696. Historical and contemporary practice demonstrate that non-debtor releases are especially appropriate when (as here) non-debtor releases and corresponding settlement payments preserve and increase the debtor's estate and thereby ensure fair and equitable recovery for creditors.

Over those decades of practice, courts have developed and applied numerous factors for determining whether a non-debtor release is "appropriate" in a given case. §1123(b)(6); see H. Friendly, Indiscretion About Discretion, 31 Emory L. J. 747, 771–773 (1982) (noting the common-law-like process by which factors important to a discretionary decision develop over time). Those factors reflect the fact that determining whether a non-debtor release is "appropriate" is a holistic inquiry that depends on the precise facts and circumstances of each case. And the factors have served to confine the use of non-debtor releases to well-defined and narrow circumstances—precisely those circumstances where the collective-action problems arise.

For instance, since the 1980s, the Second Circuit has been a leader on the non-debtor release issue. See, *e.g.*, *Johns-Manville Corp.*, 837 F. 2d 89 (1988); *In re Drexel Burnham Lambert Group, Inc.*, 960 F. 2d 285 (1992); *In re Metromedia Fiber Network, Inc.*, 416 F. 3d 136 (2005). Over time, the Second Circuit has developed a non-exhaustive list of factors for determining whether a non-debtor release is appropriately employed and appropriately tailored in a given case.

First, and critically, the court must determine whether the released party is closely related to the debtor—for example, through an indemnification agreement—where "a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate." 69 F. 4th, at 78 (quotation marks omitted). Second, the court must determine if the claims against the non-debtor are "factually and legally intertwined" with claims against the debtor. *Ibid.* Third, the court must ensure that the "scope of the releases" is tailored to only the claims that must be released to protect the plan. *Ibid.* Fourth, even then, the court should approve the release only if it is truly "essential" to the plan's success and the reorganization would fail without it. *Ibid.* Fifth, the court must consider whether, as part of the settlement, the non-debtor party has paid "substantial assets" to the estate. *Ibid.* Sixth, the court should determine if the plan provides "fair payment" to creditors for their released claims. *Id.*, at 79. Seventh, the court must ensure that the creditors "overwhelmingly" approve of the release, which the Second Circuit defined as a 75 percent "bare minimum." *Id.*, at 78–79 (quotation marks omitted).[2]

Factors one through four ensure that the releases are necessary to solve collective-action problems that threaten the bankruptcy and prevent fair and equitable recovery for the victims and creditors. Factor five makes sure that the releases are not a free ride for the non-debtor. Factor six ensures that the victims and creditors receive fair compensation. Together, factors five and six assess whether there has been a fair settlement given the probability of victims' and creditors' recovery from the non-debtor and the likely amount of any such recovery. And factor seven ensures that the vast majority of victims and creditors approve, meaning that the release is solving a holdout problem.

As the Courts of Appeals' comprehensive factors illustrate, §1123(b)(6) limits a bankruptcy court's authority in important respects. A non-debtor release must be "appropriate" given all of the facts and circumstances of the case. And as the history of non-debtor releases illustrates, the appropriateness requirement confines the use of non-debtor releases to narrow and relatively rare circumstances where the releases are necessary to help victims and creditors achieve fair and equitable recovery.

As long as every class of victims and creditors supports the plan by a majority vote in number and at least a two-thirds vote in amount, the plan is "said to be confirmed consensually," "even if some classes have dissenting creditors." 7 Collier, Bankruptcy ¶1129.01, at 1129–13. And the Courts of Appeals have allowed non-debtor

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[2] Other Courts of Appeals have used similar factors for evaluating non-debtor releases. See, *e.g.*, *In re Seaside Engineering & Surveying, Inc.*, 780 F. 3d 1070, 1079–1081 (CA11 2015); *National Heritage Foundation, Inc.* v. *Highbourne Foundation*, 760 F. 3d 344, 347–351 (CA4 2014); *In re Dow Corning Corp.*, 280 F. 3d 648, 658–661 (CA6 2002).

releases only when there is an even higher level of supermajority victim and creditor approval. In the mass-tort bankruptcy cases, most plans have easily cleared that bar and received close to 100 percent approval. *E.g.*, *Johns-Manville Corp.*, 68 B. R., at 631 (95 percent approval); *A. H. Robins Co.*, 880 F. 2d, at 700 (over 94 percent approval); *Dow Corning*, 287 B. R., at 413 (over 94 percent approval); 69 F. 4th, at 82 (over 95 percent approval here). So in reality, as opposed to rhetoric, the non-debtor releases in mass-tort bankruptcy plans, including this one, have been approved by all but a comparatively small group of victims and creditors.

In every bankruptcy of this kind, moreover, the plan nonconsensually releases victims' and creditors' claims *against the debtor*. The only difference with non-debtor releases is that they release victims' and creditors' claims not against the debtor but rather against non-debtors who are closely related to the debtor, such as indemnified officers and directors.

II

In this case, as in many past mass-tort bankruptcies, the non-debtor releases were appropriate and therefore authorized by 11 U. S. C. §1123(b)(6) of the Code. The non-debtor releases were needed to ensure meaningful victim and creditor recovery in the face of multiple collective-action problems.

A

Purdue Pharma was a pharmaceutical company owned and directed by the extended Sackler family. Brothers Arthur, Mortimer, and Raymond Sackler purchased the company in 1952. Since then, Purdue has been wholly owned by entities and trusts established for the benefit of Mortimer Sackler's and Raymond Sackler's families and descendants, and those families also closely controlled Purdue's operations.

In the 1990s, Purdue developed the drug OxyContin, a powerful and addictive opioid painkiller. Purdue aggressively marketed that drug and downplayed or hid its addictive qualities. OxyContin helped people to manage pain. But the drug's addictive qualities led to its widespread abuse. OxyContin played a central role in the opioid-abuse crisis from which millions of Americans and their families continue to suffer.

Starting in the early 2000s, governments and individual plaintiffs began to sue Purdue for the harm caused by OxyContin. In 2007, Purdue settled large swaths of those claims and pled guilty to felony misbranding of OxyContin.

But within the next decade, victims of the opioid crisis and their families, along with state and local governments fighting the crisis, began filing a new wave of lawsuits, this time also naming members of the Sackler family as defendants. Today, those claims amount to more than $40 *trillion* worth of alleged damages against Purdue and the Sacklers. (For perspective, $40 trillion is about seven times the total annual spending of the U. S. Government.)

As the litigation by victims and state and local governments mounted, the U. S. Government then brought federal criminal and civil charges against Purdue. The U. S. Government has not brought criminal charges against any of the Sacklers individually. Nor have any States brought criminal charges against any of the Sacklers individually.

As to the criminal charges against Purdue, the company pled guilty to conspiracy to defraud the United States, to violate the Food, Drug, and Cosmetic Act, and to violate the federal anti-kickback statute. As part of the global resolution of the charges, Purdue agreed to a $2 billion judgment to the U. S. Government that would be "deemed to have the status of an allowed superpriority" claim in bankruptcy. 17 App. in No. 22–110 etc. (CA2), p. 4804. The U. S. Government agreed not to "initiate any further criminal charges against Purdue." 16 *id.,* at 4798.

Unable to pay its colossal potential liabilities, Purdue filed for bankruptcy under Chapter 11 of the Bankruptcy Code. The ensuing case exemplified the flexibility and common sense of the bankruptcy system at work.

The proceedings were extraordinarily complex. The case involved "likely the largest creditor body ever," and the number of claims filed—totaling more than 600,000—was likely "a record." *In re Purdue Pharma L. P.*, 633 B. R. 53, 58 (Bkrtcy. Ct. SDNY 2021). Further complicating matters was the need to allocate funds between, on the one hand, individual victims and the hospitals that urgently needed relief and, on the other hand, government entities at all levels that urgently needed funds for opioid crisis prevention and treatment efforts. *Id.*, at 83.

Aided by perhaps "the most extensive discovery process" that "any court in bankruptcy has ever seen," the parties engaged in prolonged arms-length negotiations. *Id.*, at 85–86. They ultimately agreed on a multi-faceted compensation plan for the victims and creditors and reorganization plan for Purdue. Under that plan, Purdue would cease to exist and would be replaced with a new company that would manufacture opioid-abatement medications. And approximately $7 billion would be distributed among nine trusts to compensate victims and creditors and to fund efforts to abate the opioid crisis by preventing and treating addiction.

To determine how to allocate the $7 billion, the victims and creditors then engaged in a series of "heavily negotiated and intricately woven compromises" and devised a "complex allocation" of the funds to different classes of victims and creditors. *Id.*, at 83, 90. In the end, more than 95 percent of voting victims and creditors approved of the distribution scheme.

That plan would distribute billions of dollars to communities to use exclusively for prevention and treatment programs. And $700 to $750 million was set aside to compensate individual tort victims and their families. 1 App. 561. Opioid victims and their families would each receive somewhere between $3,500 and $48,000 depending on the category of claim and level of harm. *Id.*, at 573–584; 6 App. in No. 22–110 etc. (CA2), at 1695.

B

Under the reorganization plan, victims' and creditors' claims *against Purdue Pharma* were released (even if some victims and creditors did not consent). As in other mass-tort bankruptcies described above, a related and equally essential facet of the Purdue plan was the non-debtor release provision. Under that provision, the victims' and creditors' claims *against the Sacklers* were also released. As a result, Purdue's victims and creditors could not later sue either Purdue Pharma or members of the Sackler family (the officers and directors of Purdue Pharma) for Purdue's and the Sacklers' opioid-related activities.

The non-debtor release provision prevented a race to the courthouse against the Sacklers. As a result, the non-debtor release provision solved two separate collective-action problems that dogged Purdue's mass-tort bankruptcy: (i) It protected Purdue's estate from the risk of being depleted by indemnification claims, and (ii) it operated as a settlement of potential claims against the Sacklers and thus enabled the Sacklers' large settlement payment to the estate. That settlement payment in turn quadrupled the amount in the Purdue estate and enabled substantially greater recovery for the victims.

I will now explain both of those important points in some detail.

First, and critical to a proper understanding of this case, the non-debtor release provision was essential to *preserve*

Purdue's existing assets. By preserving the estate, the non-debtor release provision ensured that the assets could be fairly and equitably apportioned among all victims and creditors rather than devoured by one group of potential plaintiffs.

How? Pursuant to a 2004 indemnification agreement, Purdue had agreed to pay for liability and legal expenses that officers and directors of Purdue faced for decisions related to Purdue, including opioid-related decisions. See *In re Purdue Pharma L. P.*, 69 F. 4th 45, 58–59 (CA2 2023). That indemnification agreement covered judgments against the Sacklers and related legal expenses.

As explained above, the Sacklers wholly owned and controlled Purdue, a closely held corporation. The Sacklers "took a major role" in running Purdue, including making decisions about "Purdue's practices regarding its opioid products." 633 B. R., at 93. In short, the Sacklers potentially shared much of the liability that Purdue faced for Purdue's opioid practices. See *In re Purdue Pharma, L. P.*, 635 B. R. 26, 87 (SDNY 2021) (claims against the Sacklers are "deeply connected with, if not entirely identical to," claims against Purdue (quotation marks omitted)); see also 633 B. R., at 108.

But due to the indemnification agreement, if victims and creditors were to sue the Sacklers directly for claims related to Purdue or opioids, the Sacklers would have a reasonable basis to seek reimbursement from Purdue for liability and litigation costs. So Purdue could potentially be on the hook for a substantial amount of the Sacklers' liability and litigation costs. In such indemnification relationships, "a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate." 69 F. 4th, at 78 (quotation marks omitted).

As a real-world matter, therefore, opioid-related claims *against the Sacklers* could come out of the same pot of Purdue money as opioid-related claims *against Purdue*. So releasing claims against the Sacklers is not meaningfully different from releasing claims against Purdue itself, which the bankruptcy plan here of course also mandated. Both sets of releases were necessary to preserve Purdue's estate so that it was available for all victims and creditors to recover fairly and equitably. Otherwise, the estate could be zeroed out: A few victims or creditors could race to the courthouse and obtain recovery from Purdue or the Sacklers (ultimately the same pot of money) and thereby deplete the assets of the company and leave nothing for everyone else.

To fully understand why both sets of releases were necessary—against Purdue and against the Sacklers—suppose that the plan did *not* release the Sacklers from opioid- and Purdue-related liability. Victims' and creditors' opioid-related claims *against Purdue* would be discharged in Purdue's bankruptcy (even without their consent). But any victims or creditors could still sue *the Sacklers* for essentially the same claims.

Suppose that a State or a group of victims sued the Sacklers and received a large reward. The Sacklers "would have a reasonable basis to seek indemnification" from Purdue for judgments and legal expenses. *Id.*, at 72. Therefore, any liability judgments and litigation costs for certain plaintiffs in their suits *against the Sacklers* could "deplete the *res*" of *Purdue's* bankruptcy—meaning that there might well be nothing left for all of the other victims and creditors. *Id.*, at 80. Even if the Sacklers' indemnification claims against Purdue were unsuccessful, Purdue would "be required to litigate" those claims, which would likely diminish the *res*, "no matter the ultimate outcome of those claims." *Ibid.*

Every victim and creditor knows that a single judgment by someone else against the Sacklers could deplete the Purdue estate and leave nothing for anyone else. So every victim and creditor would have an incentive to race to the courthouse to sue the Sacklers. A classic collective-action problem.

The non-debtor releases of claims against the Sacklers prevented that collective-action problem in the same way that the releases of claims against Purdue itself prevented the identical collective-action problem. Both protected Purdue's assets from being consumed by the first to sue successfully. And the non-debtor releases were narrowly tailored to the problem. The non-debtor releases enjoined victims and creditors from bringing claims against the Sacklers only in cases where Purdue's conduct, or the victims' or creditors' claims asserted against Purdue, was a legal cause or a legally relevant factor to the cause of action against the Sacklers. 633 B. R., at 97–98 (defining the release to encompass only claims that "directly affect the *res* of the Debtors' estates," such as claims that would trigger the Sacklers' "rights to indemnification and contribution"); see also *id*., at 105. In other words, the releases applied only to claims for which the Sacklers had a reasonable basis to seek coverage or reimbursement from Purdue.

The non-debtor release provision therefore released claims against the Sacklers that are essentially the same as claims against Purdue. Doing so preserved Purdue's bankruptcy estate so that it could be fairly apportioned among the victims and creditors.

Second, the non-debtor releases not only *preserved* the existing Purdue estate; those non-debtor releases also greatly *increased* the funds in the Purdue estate so that the victims and creditors could receive greater compensation.

Standing alone, Purdue's estate is estimated to be worth approximately $1.8 billion—a small fraction of the sizable claims against Purdue. *Id*., at 90; 22 App. in No. 22–110 etc. (CA2), at 6507. If that were all the money on the table, the Bankruptcy Court found, the victims and creditors "would probably recover nothing" from Purdue's estate. 633

B. R., at 109. That is because the United States holds a $2 billion "superpriority" claim, meaning that the United States would be first in line to recover ahead of all of the victims and other creditors. The United States' claim would wipe out Purdue's entire $1.8 billion value. "As a result, many victims of the opioid crisis would go without any assistance." 69 F. 4th, at 80.

So for the victims and other creditors to have any hope of meaningful recovery, Purdue's bankruptcy estate needed more funds.

Where to find those funds? The Sacklers' assets were the answer. After vigorous negotiations, a settlement was reached: In exchange for the releases, the Sacklers ultimately agreed to make significant payments to Purdue's estate—between $5.5 and $6 billion. Adding that substantial amount to Purdue's comparatively smaller bankruptcy estate enabled Purdue's reorganization plan to distribute an estimated $7 billion or more to the victims and creditors—thereby quadrupling the size of the estate available for distribution. With that enhanced estate, the plan garnered 95 percent support from the voting victims and creditors. That high level of support tends to show that this was a very good plan for the victims and creditors. Because it led to that high level of support, the Sacklers' multi-billion-dollar payment was critical to creating a successful reorganization plan.

That payment was made possible by heavily negotiated settlements among Purdue, the victims and creditors, and the Sacklers. Most relevant here, in exchange for the Sacklers agreeing to pay billions of dollars to the bankruptcy estate, the victims and creditors agreed to release their claims against the Sacklers. The settlement—exchanging releases for the Sacklers' $5.5 to $6 billion payment—enabled the victims and creditors to avoid "the significant risk, cost and delay (potentially years) that would result from pursuing the Sacklers and related parties through litigation." 1 App. 31.

Indeed, after a 6-day trial involving 41 witnesses, the Bankruptcy Court found that the settlement provided the best chance for the victims and creditors to ever see any money from the Sacklers. See 633 B. R., at 85, 90. (That is a critical point that the Court today whiffs on.) Indeed, the Bankruptcy Court found that the victims and creditors would be unlikely to recover from the Sacklers by suing the Sacklers directly due to numerous potential weaknesses in and defenses to the victims' and creditors' legal theories. See *id.*, at 90–93, 108. Even if the suits were successful, the Bankruptcy Court expressed "significant concern" about the ability to collect any judgments from the Sacklers due to the difficulty of reaching their assets in foreign countries and in spendthrift trusts. *Id.*, at 89; see also *id.*, at 108–109.

For those reasons, the Bankruptcy Court concluded that the $5.5 to $6 billion settlement payment and the releases were fair and equitable and in the victims' and creditors' best interest. *Id.*, at 107–109, 112. The settlement amount of $5.5 to $6 billion was "properly negotiated" and "reflects the underlying strengths and weaknesses of the opposing parties' legal positions and issues of collection." *Id.*, at 93.[3]

From the victims' and creditors' perspective, "suing the Sacklers would have been a costly endeavor with a small chance of success. From the Sacklers' perspective, defending those suits would have been a costly endeavor

[3] The Court implies that some victims could recover from the Sacklers in tort litigation up to the total of their combined assets, and that the Sacklers are somehow getting off easy by paying only $5.5 to $6 billion. But the Court's belief is not rooted in reality given the Bankruptcy Court's undisputed factual findings to the contrary: Large tort recoveries against any of the Sacklers were (and remain) far from certain—and in any event would produce recoveries for only a few and leave other victims with nothing.

with a very small chance of a large liability." A. Casey & J. Macey, In Defense of Chapter 11 for Mass Torts, 90 U. Chi. L. Rev. 973, 1004 (2023). So as in many litigation settlements, the parties agreed to the $5.5 to $6 billion settlement in light of that "very small chance of a large liability." *Ibid*.

Importantly, the victims and creditors—who obviously have no love for the Sacklers—insisted on the releases of their claims against the Sacklers. Tr. of Oral Arg. 61, 93; Brief for Respondent Official Committee of Unsecured Creditors of Purdue Pharma L. P. et al. 10. Why did the releases make sense for the victims and creditors?

For starters, the releases were part of the settlement and enabled the Sacklers' $5.5 to $6 billion settlement payment. Moreover, without the releases, some of Purdue's victims and creditors—maybe a State, maybe some opioid victims—would sue the Sacklers directly for claims "deeply connected with, if not entirely identical to," claims that the victims and creditors held against Purdue. 635 B. R., at 87 (quotation marks omitted). To be sure, the Bankruptcy Court found that those suits would face significant challenges. But the victims and creditors were understandably worried, as they explained during the Bankruptcy Court proceedings, that the Sacklers would "exhaust their collectible assets fighting and/or paying ONLY the claims of certain creditors with the best ability to pursue the Sacklers in court." 1 App. 76. And if even a *single* direct suit against the Sacklers succeeded, the suit could potentially wipe out much if not all of the Sacklers' assets in one fell swoop—making those assets unavailable for the Purdue estate and therefore unavailable for all of the other the victims and creditors.

In sum, if there were no releases, and victims and creditors were therefore free to sue the Sacklers directly, one of three things would likely happen. One possibility is that no lawsuits against the Sacklers would succeed, and no victim or creditor would recover any money from them. And without the $5.5 to $6 billion settlement payment, there would be no recovery from Purdue either. Another possibility is that a large claim or claims would succeed, and the Sacklers would be indemnified by Purdue—thereby wiping out Purdue's estate for all of the other victims and creditors. Last, suppose that a large claim succeeded and that the Sacklers were not indemnified for that liability. Even in that case, only a few victims or creditors would be able to recover from the Sacklers at the expense of fair and equitable distribution to the rest of the victims and creditors.

As the Second Circuit stated, without the releases, the victims and creditors "would go without any assistance and face an uphill battle of litigation (in which a single claimant might disproportionately recover) without fair distribution." 69 F. 4th, at 80. Another classic collective-action problem.

In short, without the releases and the significant settlement payment, two separate collective-action problems stood in the way of fair and equitable recovery for the victims and creditors: (1) the Purdue estate would not be preserved for the victims and creditors to obtain recovery, and (2) the Purdue estate would be much smaller than it would be with the Sacklers' settlement payment. The releases and settlement payment solved those problems and ensured fair and equitable recovery for the opioid victims.

C

For those reasons, the Bankruptcy Court found that without the releases and settlement payment, the reorganization plan would "unravel." 633 B. R., at 107, 109. All of the "heavily negotiated and intricately woven compromises in the plan" that won the victims' and creditors' approval, *id.*, at 90, would "fall apart for lack of funding and the inevitable fighting over a far smaller and less certain recovery with its renewed focus on pursuing individual claims and races to collection." *Id.*, at 84. There simply would not be enough money to support a reorganization plan that the victims and creditors would approve.

Absent the releases and settlement payment, the Bankruptcy Court found, the "most likely result" would be liquidation of a much smaller $1.8 billion estate. *Id.*, at 90. In a liquidation, the United States would recover first with its $2 billion superpriority claim, taking for itself the whole pie. And the victims and other creditors "would probably recover nothing." *Id.*, at 109.

Given that alternative, it is hardly surprising that the opioid victims and creditors almost universally support Purdue's Chapter 11 reorganization plan and the non-debtor releases. That plan promised to obtain significant assets from the Sacklers, to preserve those assets from being depleted by litigation for a few, and to distribute those much-needed funds fairly and equitably.

As a result, the opioid victims' and creditors' support for the reorganization plan was *overwhelming*. Every victim and creditor had a chance to vote on the plan during the bankruptcy proceedings. And of those who voted, more than 95 percent approved of the plan. *Id.*, at 107.

Since then, even more victims and creditors have gotten on board. Now, all 50 States have signed on to the plan. The lineup before this Court is telling. On one side of the case: the tens of thousands of opioid victims and their families; more than 4,000 state, city, county, tribal, and local government entities; and more than 40,000 hospitals and healthcare organizations. They all urge the Court to uphold the plan.

At this point, on the other side of this case stand only a sole individual and a small group of Canadian creditors.[4]

Given all of the extraordinary circumstances, the Bankruptcy Court and Second Circuit concluded that the non-debtor releases here not only were appropriate, but were essential to the success of the plan. The Bankruptcy Court and Second Circuit thoroughly analyzed each of the relevant factors before reaching that conclusion: First, the released non-debtors (the Sacklers) closely controlled and were indemnified by the company. 69 F. 4th, at 79. Second, the claims against the Sacklers were based on essentially the same facts and legal theories as the claims against Purdue. *Id.*, at 80. Third, the releases were essential for the reorganization to succeed, because the releases protected the Purdue estate from indemnification claims and expanded the Purdue estate to enable victim and creditor recovery. *Id.*, at 80–81. Fourth, the releases were narrowly tailored to protect the estate from indemnification claims. *Ibid.* Fifth, the releases secured a substantial settlement payment to significantly increase the funds in the estate. *Id.*, at 81. Sixth, that enhanced estate allowed the plan to distribute "fair and equitable" payments to the victims and creditors. *Id.*, at 82 (quotation marks omitted). And seventh, for all those reasons, the victims and creditors do not just urgently and overwhelmingly approve of the releases, they all but demanded the releases. *Ibid.*

Congress invited bankruptcy courts to consider exactly those kinds of extraordinary circumstances when it

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[4] The regional United States Trustee for three States, a Government bankruptcy watchdog appointed to oversee bankruptcy cases in those States, also opposes the plan for reasons that remain mystifying. The U. S. Trustee purports to look out for victims and creditors, but here the victims and creditors made emphatically clear that the "U. S. Trustee does not speak for the victims of the opioid crisis" and is indeed thwarting the opioid victims' efforts at fair and equitable recovery. Tr. of Oral Arg. 93.

authorized bankruptcy plans to include "any other appropriate provision" that is "not inconsistent" with the Code. §1123(b)(6).

III

The Court decides today to reject the plan by holding that non-debtor releases are categorically impermissible as a matter of law. That decision contravenes the Bankruptcy Code. It is regrettable for the opioid victims and creditors, and for the heavily negotiated equitable distribution of assets that they overwhelmingly support. And it will harm victims in pending and future mass-tort bankruptcies. The Court's decision deprives the bankruptcy system of a longstanding and critical tool that has been used repeatedly to ensure fair and sizable recovery for victims—to repeat, recovery for *victims*—in mass torts ranging from Dalkon Shield to the Boy Scouts.

On the law, the Court's decision to reject the plan flatly contradicts the Bankruptcy Code. The Code explicitly grants broad discretion and flexibility for bankruptcy courts to handle bankruptcies of extraordinary complexity like this one. For several decades, bankruptcy courts have been employing non-debtor releases to facilitate fair and equitable recovery for victims in mass-tort bankruptcies. In this case, too, the Bankruptcy Court prudently and appropriately employed its discretion to fairly resolve a mass-tort bankruptcy.

At times, the Court seems to view the Sacklers' settlement payment into Purdue's bankruptcy estate as insufficient and the plan as therefore unfair to victims and creditors. If that were true, one might expect the fight in this case to be over whether the non-debtor releases and settlement amount were "appropriate" given the facts and circumstances of this case. 11 U. S. C. §1123(b)(6).

Yet that is not the path the Court takes. The Court does not contest the Bankruptcy Court's and Second Circuit's conclusion that a non-debtor release was necessary and appropriate for the settlement and the success of Purdue's reorganization—the best, and perhaps the only, chance for victims and creditors to receive fair and equitable compensation. Indeed, no party has challenged the Bankruptcy Court's factual findings or made an argument that non-debtor releases were used inappropriately in this specific case.

Instead, the Court categorically decides that non-debtor releases are *never* allowed as a matter of law. The text of the Bankruptcy Code does not remotely support that categorical prohibition.[5]

As explained, §1123(b)(6)'s catchall authority affords bankruptcy courts broad discretion to approve "any other appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code. Recall that §1123(b)(1) expressly authorizes releases of victims' and creditors' claims against the debtor company—here, against Purdue.

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[5] To remind the reader of §1123(b)'s lengthy text: A "plan may—

"(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;

"(2) subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section;

"(3) provide for—

"(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or

"(B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;

"(4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests;

"(5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims; and

"(6) include any other appropriate provision not inconsistent with the applicable provisions of this title."

And recall that §1123(b)(3) expressly authorizes settlements and releases of the debtor company's claims against non-debtors—here, against the Sacklers. Section 1123(b)(6)'s catchall authority is easily broad enough to allow settlements and releases of the same victims' and creditors' claims against the same non-debtors (the Sacklers), who are indemnified by the debtor and who made a large settlement payment to the debtor's estate. After all, the Second Circuit stated that in indemnification relationships "a suit against the non-debtor is, in essence, a suit against the debtor." *In re Purdue Pharma L. P.*, 69 F. 4th 45, 78 (2023) (quotation marks omitted). And even when the officers and directors are not indemnified, the releases may enable a settlement where the non-debtor makes a sizable payment to the estate that can be fairly and equitably distributed to the victims and creditors, rather than being zeroed out by the first successful suit.

A

So how does the Court reach its atextual and ahistorical conclusion? The Court primarily seizes on the canon of *ejusdem generis*, an interpretive principle that "limits general terms that follow specific ones to matters similar to those specified." *CSX Transp., Inc.* v. *Alabama Dept. of Revenue*, 562 U. S. 277, 294 (2011) (quotation marks and alteration omitted). But the Court's use of that canon here is entirely misguided.

The *ejusdem generis* canon "applies when a drafter has tacked on a catchall phrase at the end of an enumeration of specifics, as in *dogs, cats, horses, cattle, and other animals*." A. Scalia & B. Garner, Reading Law 199 (2012); see also *id.*, at 200–208 ("trays, glasses, dishes, or other tableware"; "gravel, sand, earth or other material"; and numerous other similar lists (quotation marks omitted)); W. Eskridge, Interpreting Law 77 (2016) ("automobiles, motorcycles, and other mechanisms for conveying persons or things" (quotation marks omitted)).

As a general matter, as Justice Scalia explained for the Court, a catchall at the end of the list should be construed to cover "matters not specifically contemplated—known unknowns." *Republic of Iraq* v. *Beaty*, 556 U. S. 848, 860 (2009). That is the "whole value of a generally phrased residual clause." *Ibid.* Or stated otherwise, the fact that "a statute can be applied in situations not expressly anticipated by Congress does not demonstrate ambiguity. It demonstrates breadth." *Pennsylvania Dept. of Corrections* v. *Yeskey*, 524 U. S. 206, 212 (1998) (quotation marks omitted).

The *ejusdem generis* canon can operate to narrow a broad catchall term in certain circumstances. The canon "parallels common usage," reflecting the assumption that when "the initial terms all belong to an obvious and readily identifiable genus, one presumes that the speaker or writer has that category in mind for the entire passage." Scalia & Garner, Reading Law, at 199. The canon in essence "implies the addition" of the term "similar" in the catchall so that the catchall does not extend so broadly as to defy common sense. *Ibid.* Rather, the catchall extends to similar things or actions that serve the same statutory "purpose." *Id.*, at 208.

Here, the Court applies the canon to breezily conclude that there is an "obvious link" through §§1123(b)(1)–(5) that precludes a non-debtor release provision being approved under §1123(b)(6). *Ante,* at 11. The obvious link, according to the Court, is that plan provisions must "concern *the debtor*—its rights and responsibilities, and its relationship with its creditors." *Ibid.*

As an initial matter, the Court does not explain why its supposed common thread excludes the non-debtor releases at issue here. Those releases obviously "concern" the debtor in multiple overlapping respects. *Ibid.* As explained, Purdue's bankruptcy plan released the Sacklers only for claims based on *the debtor's* (Purdue's) misconduct. See 69 F. 4th, at 80 (releasing only claims to which Purdue's conduct was "a legal cause or a legally relevant factor to the cause of action" (quotation marks omitted)). The releases therefore applied only to claims held by *the debtor's* victims and creditors. And the releases protected *the debtor* from indemnification claims. So the non-debtor releases here did not just "concern" the debtor, they were critical to the debtor's reorganization.

So the Court's purported "link" manages the rare feat of being so vague ("concerns the debtor"?) as to be almost meaningless—and if not meaningless, so broad as to plainly cover non-debtor releases. It is hard to conjure up a weaker *ejusdem generis* argument than the one put forth by the Court today.

In any event, even on its own terms, the Court's *ejusdem generis* argument is dead wrong for two independent reasons. First, the Court's purported common thread is factually incorrect as a description of (b)(1) to (b)(5). Second, and independent of the first point, black-letter law says that the *ejusdem generis* canon requires looking at the "evident purpose" of the statute in order to discern a common thread. Scalia & Garner, Reading Law, at 208; see Eskridge, Interpreting Law, at 78. And here, the Court's purported common thread ignores (and indeed guts) the evident purpose of §1123(b).

First, the Court's purported common thread is factually incorrect. The Court says that the "obvious link" through paragraphs (b)(1) to (b)(5) is that all are limited to "*the debtor*—its rights and responsibilities, and its relationship with its creditors." *Ante,* at 11. But in multiple respects, that assertion is not accurate.

For one thing, paragraph (b)(3) allows a bankruptcy court to modify the rights of debtors with respect to *non-debtors*. Under (b)(3), a bankruptcy court may approve a reorganization plan that settles, adjusts, or enforces "any claim" that the debtor holds against non-debtor third parties. That provision allows the debtor's estate to enter into a settlement agreement with a third party, where the estate agrees to release its claims against the third party in exchange for a settlement payment to the bankruptcy estate. And the bankruptcy court has the power to approve such a settlement if it finds the settlement fair and in the best interests of the estate. The bankruptcy court may later enforce that settlement. See generally 7 Collier on Bankruptcy ¶1123.02[3] (R. Levin & H. Sommer eds., 16th ed. 2023).

Importantly, in some cases, including this one, the debtor's creditors may hold derivative claims against that same non-debtor third party for the same "harm done to the estate." 69 F. 4th, at 70 (quotation marks omitted). So when the debtor settles with the non-debtor third party, that settlement also extinguishes the creditors' derivative claims against the non-debtor. And the creditors' consent is not necessary to do so.

To connect the dots: A plan provision settling the debtor's claims against non-debtors under (b)(3) therefore *nonconsensually extinguishes creditors' derivative claims against those non-debtors*. That fact alone defeats the Court's conclusion that §§1123(b)(1)–(5) deal only with relations between the debtor and creditors. If a plan provision under (b)(3) can nonconsensually release some of the creditors' derivative claims against a non-debtor, a plan provision under the catchall in (b)(6) that nonconsensually releases some of the creditors' direct claims against those same non-debtors is easily of a piece—basically the same thing.

This case illustrates the point. Some of the more substantial assets of Purdue's estate are fraudulent transfer claims worth $11 billion that Purdue holds against the non-debtor Sacklers. *In re Purdue Pharma L. P.*, 633

B. R. 53, 87 (Bkrtcy. Ct. SDNY 2021). Under (b)(3), as part of its reorganization plan, Purdue settled the fraudulent transfer claims with the non-debtor Sacklers. The Bankruptcy Court approved that settlement as fair and equitable. *Id.*, at 83–95. That settlement resolved the claims that likely would have had "the best chance of material success among all of the claims against" the Sacklers. *Id.*, at 109; see also *id.*, at 83.

Notably, the result of that settlement was to also *nonconsensually* extinguish the victims' and creditors' derivative fraudulent transfer claims against the Sacklers. In the absence of the bankruptcy proceeding, victims and creditors could have litigated the fraudulent transfer claims themselves as derivative claims. But because Purdue settled the claims under §1123(b)(3), the victims and creditors could no longer do so.

Moreover, not all victims and creditors consented to the release of those derivative claims. But no one disputes that the Bankruptcy Code authorized that nonconsensual non-debtor release of derivative claims. See 69 F. 4th, at 70 (that conclusion is "well-settled").

The plan therefore released both the estate's claims against the Sacklers *and* highly valuable derivative claims that the victims and creditors held against the Sacklers. Paragraph (b)(3) therefore demonstrates that §1123(b) reaches beyond just creditor-debtor relationships, particularly when the relationship between creditors and other non-debtors can affect the estate. That indisputable point alone defeats the Court's conclusion that §1123(b)'s provisions relate only to the debtor and do not allow releases of claims that victims and creditors hold against non-debtors.

The Court tries to sidestep that conclusion by distinguishing derivative claims from direct claims. Releases of derivative claims, the Court says, are authorized by paragraph (b)(3) "because those claims belong to the debtor's estate." *Ante,* at 12. No doubt. But the question then becomes whether releases of direct claims under (b)(6)'s catchall are relevantly similar to releases of derivative claims that all agree are authorized under (b)(3). The answer in this case is yes. Here, both the derivative and direct claims against the Sacklers are held by the same victims and creditors, and both the derivative and direct claims against the Sacklers could deplete Purdue's estate.

The Court's purported common thread is further contradicted by several other kinds of non-debtor releases that "are commonplace, important to the bankruptcy system, and broadly accepted by the courts and practitioners as necessary and proper" plan provisions under §1123(b)(6). Brief for American College of Bankruptcy as *Amicus Curiae* 3.

Three examples illustrate the point: consensual non-debtor releases, full-satisfaction non-debtor releases, and exculpation clauses.

Consensual non-debtor releases are routinely included in bankruptcy plans even though those releases apply to claims by victims or creditors against non-debtors—just like the claims here. And it is "well-settled that a bankruptcy court may approve" such consensual releases. 69 F. 4th, at 70; see also Brief for American College of Bankruptcy as *Amicus Curiae* 5–7.

Consensual releases are uncontroversial, but they are not expressly authorized by the Bankruptcy Code. So the only provision that could possibly supply authority to include those releases in the bankruptcy plan is the catchall in §1123(b)(6).

The Court today does not deny that consensual releases are routine in the bankruptcy context and that courts have long approved them. See *ante*, at 18–19. But where, on the Court's reading of the Bankruptcy Code, would the bankruptcy court obtain the authority to enter and later enforce that consensual release?

One suggestion is that the authority comes from the parties' consent and is akin to a "contractual agreement." Tr. of Oral Arg. 33. But that theory does not explain what provision of the Bankruptcy Code authorizes consensual releases *in bankruptcy plans*. After all, contracts are enforceable under state law, ordinarily in state courts. But in bankruptcy, consensual releases are routinely part of a reorganization plan with voting overseen by the bankruptcy court and conditions enforceable by the bankruptcy court. See Brief for American College of Bankruptcy as *Amicus Curiae* 4–7.

To reiterate, the only provision that could provide such authority is §1123(b)(6). So if the Court thinks that a consensual release can be part of the plan, even the Court must acknowledge that §1123(b)(6) can reach creditors' claims against non-debtors.

The Court's purported common thread is still further contradicted by yet another regular bankruptcy practice: full-satisfaction releases. Full-satisfaction releases provide full payment for creditors' claims against non-debtors and then release those claims. When a full-satisfaction release is included in a reorganization plan, the bankruptcy court exercises control over creditors' claims against non-debtors.

Again, the only provision that could possibly supply authority to include those full-satisfaction releases in a bankruptcy plan is the catchall in §1123(b)(6). Any contract-law theory would not work for full-satisfaction releases, given that holdout creditors often refuse to consent to full-satisfaction releases. See, *e.g.*, *In re A. H. Robins Co.*, 880 F. 2d 694, 696, 700, 702 (CA4 1989); *In re Boy Scouts of Am. and Del. BSA, LLC*, 650 B. R. 87, 115–116, 141 (Del. 2023). So if full-satisfaction releases are to be allowed, §1123(b)(6) must be read to reach creditor claims against non-debtors, even without consent.

The Court does not deny that consensual non-debtor releases and full-satisfaction releases might be permissible under §1123(b)(6). *Ante*, at 19. If they are permissible, then the Court's purported *ejusdem generis* common thread is thoroughly eviscerated because those releases involve claims by victims or creditors against non-debtors, just like here. (And if the Court instead means to hold open the possibility that consensual and full-satisfaction releases are actually impermissible, then its holding today is even more extreme than it appears.)

Exculpation clauses are yet another example. Exculpation clauses shield the estate's fiduciaries and other professionals (non-debtors) from liability for their work on the reorganization plan. See Brief for American College of Bankruptcy as *Amicus Curiae* 9. Without such exculpation clauses, "competent professionals would be deterred from engaging in the bankruptcy process, which would undermine the main purpose of chapter 11—achieving a successful restructuring." *Id.*, at 11; see also Brief for Highland Capital Management, L. P. as *Amicus Curiae* 3–5. For that reason, bankruptcy courts routinely approve exculpation clauses under §1123(b)(6). For exculpation clauses to be allowed, however, §1123(b)(6) must be read to reach creditor claims against non-debtors. So exculpation clauses further refute the Court's purported common thread.

The fact that plan provisions under §1123(b)(6) can reach non-debtors finds still more support in this Court's only case to analyze the catchall authority in §1123(b)(6), *United States* v. *Energy Resources Co.* The plan provision in *Energy Resources* ordered the IRS, a creditor, to apply the debtor's tax payments to trust-fund tax liability before other kinds of tax liability. *United States* v. *Energy Resources Co.*, 495 U. S. 545, 547 (1990). Importantly, if the debtor did not pay the trust-fund tax liability, then non-debtor officers of the company would be on the hook. *Ibid.* So the plan provision served to protect the company's non-debtor officers from "personal liability" for those taxes.

In re Energy Resources Co., 59 B. R. 702, 704 (Bkrtcy. Ct. Mass. 1986). In exchange for that protection, a non-debtor officer contributed funds to the bankruptcy plan. *Ibid.*

Echoing the Court today, the IRS objected to that plan, arguing that the bankruptcy court exceeded its authority under (b)(6) in part because there was no provision in the Code that expressly supported the plan provision. *Energy Resources*, 495 U. S., at 549–550. But this Court disagreed with the IRS and approved the plan based on the "residual authority" in (b)(6). *Id*., at 549.

The plan provision in *Energy Resources* operated akin to a non-debtor release: It reduced the potential liability of a non-debtor (the non-debtor's officers) to another non-debtor (the IRS). *Energy Resources* therefore further demonstrates that plan provisions under §1123(b)(6) can affect creditor–non-debtor relationships.

In sum, the Court's statement that §1123(b) reaches only "*the debtor*—its rights and responsibilities, and its relationship with its creditors," *ante,* at 11, is factually incorrect several times over. Paragraphs 1123(b)(3) and (b)(6) already allow plans to affect creditor claims against non-debtors, such as through releases of creditors' derivative claims, consensual releases, full-satisfaction releases, and exculpation clauses. And this Court's precedent in *Energy Resources* confirms the point. The Court's *ejusdem generis* argument rests on quicksand.

Second, independent of those many flaws, the Court's entire approach to *ejusdem generis* is wrong from the get-go. When courts face a statute with a catchall, it is black-letter law that courts must try to discern the common thread by examining the "evident purpose" of the statute. Scalia & Garner, Reading Law, at 208; see also *Begay* v. *United States*, 553 U. S. 137, 146 (2008) (defining common thread "in terms of the Act's basic purposes"); Eskridge, Interpreting Law, at 78 ("statutory purpose" helps identify the common thread in *ejusdem generis* cases).[6]

Importantly, this Court has already explained that the purpose of §1123(b) is to grant bankruptcy courts "broad power" to approve plan provisions "necessary for a reorganization's success." *Energy Resources*, 495 U. S., at 551. *Energy Resources* demonstrates that the common thread of §1123(b) is bankruptcy court action to preserve the estate and ensure fair and equitable recovery for creditors. See, *e.g.*, *Pioneer Investment Services Co.* v. *Brunswick Associates L. P.*, 507 U. S. 380, 389 (1993); *NLRB* v. *Bildisco & Bildisco*, 465 U. S. 513, 528 (1984); J. Feeney & M. Stepan, 2 Bankruptcy Law Manual §11:1 (5th ed. 2023).

As explained at length above, to maximize recovery, the Court must solve complex collective-action problems. And for a bankruptcy court to solve all of the relevant collective-action problems, §§1123(b)(1)–(5) give the bankruptcy court broad power to modify parties' rights without their consent—most notably, to release creditors' claims against the debtor. §1123(b)(1). Under that provision, the Purdue plan released the victims' and creditors' claims *against Purdue* in order to prevent a collective-action problem in distributing Purdue's assets—and thereby to preserve the estate and ensure fair and equitable recovery for victims and creditors.

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[6] The Court protests that we are looking to the "purpose" of the statute. But in *ejusdem generis* cases, courts are *required* to look at "purpose" in order to determine the common link, as Scalia and Garner and Eskridge all say, and as *Begay* indicated. That is longstanding black-letter law. And even outside the *ejusdem generis* context, the Court's allergy to the word "purpose" is strange. After all, "words are given meaning by their context, and context includes the purpose of the text. The difference between textualist interpretation" and "purposive interpretation is not that the former never considers purpose. It almost always does," but "the purpose must be derived from the text." A. Scalia & B. Garner, Reading Law 56 (2012).

The non-debtor release provision approved under §1123(b)(6) does the same thing and serves that same statutory purpose. As discussed above, the victims' and creditors' claims against the non-debtor Purdue officers and directors (the Sacklers) are essentially the same as their claims against Purdue. The claims against the Sacklers rest on the same legal theories and facts as the claims against Purdue, largely the Sacklers' opioid-related decisions in running Purdue. And the Sacklers are indemnified by Purdue's estate for their liability. So any liability could potentially come out of the Purdue estate just like the claims against Purdue itself.

Therefore, the nonconsensual releases against the Sacklers are not only of a similar genus, but in effect *the same thing* as the nonconsensual releases against Purdue that everyone agrees §1123(b)(1) already authorizes. Both were necessary to preserve the estate and prevent collective-action problems that could drain Purdue's estate, and thus both were necessary to enable Purdue's reorganization plan to succeed and to equitably distribute assets. And without the releases, there would be no settlement, meaning no $5.5 to $6 billion payment by the Sacklers to Purdue's estate. That would mean either that no victim or creditor could recover anything from the Sacklers (or indeed from Purdue), or that only a few victims or creditors could recover from the Sacklers at the expense of fair and equitable distribution to everyone else.

The statute's evident purpose therefore easily answers the *ejusdem generis* inquiry here. Absent other limitations and restrictions in the Code, §1123(b)(6) authorizes a bankruptcy court to modify parties' claims that could otherwise threaten to deplete the bankruptcy estate when doing so is necessary to preserve the estate and provide fair and equitable recovery for creditors.

In light of the "evident purpose" of §1123(b) to preserve the estate and ensure fair and equitable recovery for creditors in the face of collective-action problems, Scalia & Garner, Reading Law, at 208; see Eskridge, Interpreting Law, at 78, the Court's *ejusdem generis* theory simply falls apart.

In sum, for each of two independent reasons, the Court's *ejusdem generis* argument fails. First, its common thread is factually wrong. And second, its purported common thread disregards the evident purpose of §1123(b).

B

Despite the fact that non-debtor releases address the very collective-action problem that the bankruptcy system was designed to solve, the Court next trots out a few minimally explained arguments that non-debtor release provisions are "inconsistent with" various provisions of the Bankruptcy Code, including: (i) §524(g)'s authorization of non-debtor releases in asbestos cases; (ii) §524(e)'s statement that debtors' discharges do not automatically affect others' liabilities; and (iii) the Code's various restrictions on bankruptcy discharges. None of those arguments is persuasive.

First, the Court cites §524(g), which was enacted in 1994 to expressly authorize non-debtor releases in a specific context: cases involving mass harm "caused by the presence of, or exposure to, asbestos or asbestos-containing products." §524(g)(2)(B)(i)(I). From the fact that §524(g) allows non-debtor releases in the asbestos context, the Court infers that non-debtor releases are prohibited in other contexts. *Ante,* at 15.

But the very text of §524(g) *expressly precludes* the Court's inference. The statute says: "Nothing in [§524(g)] shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization." 108 Stat. 4117, note following 11 U. S. C. §524. Congress expressly authorized non-debtor releases in one specific context that was critically urgent in 1994 when it was enacted. But Congress also enacted the corresponding rule of construction into binding statutory text to "make clear" that §524(g) did not "alter" the bankruptcy courts' ability to use non-debtor release mechanisms as appropriate in other cases. 140 Cong. Rec. 27692 (1994).

Keep in mind that Congress enacted §524(g) in the early days of non-debtor releases, soon after bankruptcy courts began approving non-debtor releases in asbestos cases. See, *e.g.*, *In re Johns-Manville Corp.*, 68 B. R. 618, 621–622 (Bkrtcy. Ct. SDNY 1986), aff'd, 837 F. 2d 89, 90 (CA2 1988); *UNARCO Bloomington Factory Workers* v. *UNR Industries, Inc.*, 124 B. R. 268, 272, 278–279 (ND Ill. 1990). Section 524(g) set forth a detailed scheme sensitive to the specific needs of asbestos mass-tort litigation that was then engulfing and overwhelming American courts. For example, because asbestos injuries often have a long latency period, asbestos mass-tort bankruptcies needed to account for unknown claimants who could come out of the woodwork in the future. See Bankruptcy Reform Act of 1994, 108 Stat. 4114–4116; *In re Johns-Manville Corp.*, 68 B. R., at 627–629.

But as explained above, throughout the history of the Code and at the time §524(g) was enacted, bankruptcy courts were also issuing non-debtor releases in other contexts as well, such as in the Dalkon Shield mass-tort bankruptcy case. *A. H. Robins Co.*, 880 F. 2d, at 700–702; see also, *e.g.*, *In re Drexel Burnham Lambert Group, Inc.*, 960 F. 2d 285, 293 (CA2 1992) (securities litigation context). Congress therefore made clear that enacting §524(g) for the urgent asbestos cases did not disturb bankruptcy courts' preexisting authority to issue such releases in other cases.

Bottom line: The Court's reliance on §524(g) directly contravenes the actual statutory text.

Second, the Court cites §524(e), which states that a plan's discharge of the debtor "does not affect the liability of any other entity on . . . such debt." By its terms, §524(e) does not purport to preclude releases of creditors' claims against non-debtors. (And were the rule otherwise, even consensual releases would be prohibited as well.)

Notably, Congress changed §524(e) to its current wording in 1979. Before 1979, the statute arguably did preclude releases of claims against non-debtors who were co-debtors with a bankrupt company. See 11 U. S. C. §34 (1976 ed.) (repealed Oct. 1, 1979) ("The liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt *shall not* be altered by the discharge of such bankrupt" (emphasis added)). But Congress then changed the law. And the text now means only that the discharge of the debtor does not *itself* automatically wipe away the liability of a non-debtor. Section 524(e) does not speak to the issue of non-debtor releases or other steps that a plan may take regarding the liability of a non-debtor for the same debt. As the American College of Bankruptcy says, "Section 524(e) is agnostic as to third-party releases." Brief for American College of Bankruptcy as *Amicus Curiae* 6, n. 3; see also *In re Airadigm Communications, Inc.*, 519 F. 3d 640, 656 (CA7 2008).

Third, citing §§523(a), 524(a), and 541(a), the Court says that the plan improperly grants a "discharge" to the Sacklers. *Ante,* at 4, 14–15. And the Court suggests that giving the Sacklers a "discharge" in Purdue's bankruptcy plan in exchange for \$5.5 to \$6 billion allows the Sacklers to get away too easy—without filing for bankruptcy themselves, without having to comply with the Code's various restrictions, and without paying enough. See *ante,* at 14–15. That point also fails.

To begin, the premise is incorrect. The Sacklers did not receive a bankruptcy discharge in this case. Discharge is a term of art in the Bankruptcy Code. *Wainer* v. *A. J. Equities, Ltd.*, 984 F. 2d 679, 684 (CA5 1993); J. Silverstein, Hiding in Plain View: A Neglected Supreme Court Decision

Resolves the Debate Over Non-Debtor Releases in Chapter 11 Reorganizations, 23 Emory Bkrtcy. Developments J. 13, 130 (2006). When a debtor in bankruptcy receives a discharge, most (if not all) of their pre-petition debts are released, giving the debtor a fresh start. See §1141(d)(1) (Chapter 11 discharge relieves the debtor "from any debt that arose before the date of" plan confirmation, with narrow exceptions); *Taggart* v. *Lorenzen*, 587 U. S. 554, 556, 558 (2019). The Sacklers did not receive such a discharge.

As courts have always recognized, non-debtor releases are different. Non-debtor releases "do not offer the umbrella protection of a discharge in bankruptcy." *Johns-Manville Corp.*, 837 F. 2d, at 91. Rather, non-debtor releases are accompanied by settlement payments to the estate by the non-debtor. So non-debtor releases are simply one part of a settlement of pending or potential claims against the non-debtor that arise out of some torts committed by the debtor. They are in essence a traditional litigation settlement. They are not a blanket discharge for the non-debtor.

Here, therefore, the releases apply only to certain claims against the Sacklers—namely, those "that arise out of or relate to" Purdue's bankruptcy. *Ibid.*; see 69 F. 4th, at 80 (releasing the Sacklers only for claims to which Purdue's conduct was "a legal cause or a legally relevant factor to the cause of action" (quotation marks omitted)). And the non-debtor releases were negotiated in exchange for a significant settlement payment that enabled *Purdue's* bankruptcy reorganization to succeed.

In short, the releases do not grant discharges to non-debtors and cannot be disallowed on that basis.

Next, the Court suggests that the Sacklers must file for bankruptcy themselves in order to be released from liability. That, too, is incorrect. Nowhere does the Code say that a non-debtor may be released from liability only by filing for bankruptcy. On the contrary, §1123(b)(3) of the Code already expressly allows a bankruptcy plan to release a non-debtor from liability to the debtor.

The Court's suggestion that a non-debtor must file for bankruptcy in order to be released from liability not only is directly at odds with the text of the Code, but also is at odds with reality. Non-debtor releases are often used in situations where it is not possible or practicable for the non-debtors to simply file for individual bankruptcies. This case is just one example. The "Sacklers are not a simple group of a few defendants" that could simply have declared one bankruptcy. 633 B. R., at 88. They are "a large family divided into two sides, Side A and Side B, with eight pods or groups of family members within those divisions," many of whom live abroad (beyond bankruptcy jurisdiction). *Ibid*. And their assets are spread across trusts that are likely beyond the jurisdiction of U. S. courts as well. *Ibid*.; see also *id*., at 109.

Likewise, in many other mass-tort bankruptcy cases, released non-parties could not simply declare their own bankruptcies either. Insurers, for example, cannot declare bankruptcy just because a policy limit is reached. B. Zaretsky, Insurance Proceeds in Bankruptcy, 55 Brooklyn L. Rev. 373, 394–395, and n. 60 (1989). And in cases involving hundreds of affiliated entities who share liability and share insurance, such as the Boy Scouts and the Catholic Church, it would be almost impossible to coordinate assets and ensure equitable victim recovery across hundreds of distinct bankruptcies. Section §1123(b)(6) provides bankruptcy courts with flexibility to deal with such situations by approving appropriate non-debtor releases. See Brief for Boy Scouts of America as *Amicus Curiae* 18–20; Brief for Ad Hoc Group of Local Councils of the Boy Scouts of America as *Amicus Curiae* 6; Brief for U. S. Conference of Catholic Bishops as *Amicus Curiae* 3–4, 17–22.

The Court next says that the non-debtor release allowed the Sacklers to bypass certain restrictions on discharges—for example, that individual debtors are generally not discharged for fraud claims, §523(a). That argument fails for the same reason. Non-debtor releases are part of a negotiated settlement of potential tort claims. They are not a discharge. And nothing in §523(a) prohibits a debtor's reorganization plan from *releasing* non-debtors for fraud claims. Indeed, it is undisputed that Purdue's bankruptcy could release the Sacklers from at least some fraud claims—namely, the fraudulent transfer claims—under §1123(b)(3). No provision in the Code forbids releasing other fraud claims against the Sacklers, too. The Court's concern that the releases apply to claims for "fraud," *ante,* at 15, therefore falls flat.

In all of those scattershot arguments, the Court seems concerned that the Sacklers' $5.5 to $6 billion settlement payment was not enough. To begin with, even if that were true, it would not be a reason to *categorically* disallow non-debtor releases as a matter of law, as the Court does today. In any event, that concern is unsupported by the record and contradicted by the Bankruptcy Court's undisputed findings of fact. The Bankruptcy Court found that the creditors' and victims' ability to recover directly from any of the Sacklers in tort litigation was far from certain. So as in other tort settlements, the settlement amount here reflected the parties' assessments of their probabilities of success and the likely amount of possible recovery. The Court today has no good basis for its subtle second-guessing of the settlement amount.

And lest we miss the forest for the trees, keep in mind that the victims and creditors have no incentive to short their own recoveries or to let the Sacklers off easy. They despise the Sacklers. Yet they strongly support the plan. They call the settlement a "remarkable achievement." Brief for Respondent Ad Hoc Group of Individual Victims of

Purdue Pharma, L. P. et al. 2. And given the high level of victim and creditor support, the Bankruptcy Court emphasized: "[T]his is *not* the Sacklers' plan," and "anyone who contends to the contrary" is "simply misleading the public." 633 B. R., at 82.

The Court today unfortunately falls into that trap. And it is rather paternalistic for the Court to tell the victims that they should have done better—and then to turn around and leave them with potentially nothing.

C

Finally, the Court suggests that non-debtor releases are not "appropriate" because they are inconsistent with history and practice. That, too, is seriously mistaken.

Importantly, Congress did not enact the current Bankruptcy Code—and with it, §1123(b)(6)—until 1978. Bankruptcy Code of 1978, 92 Stat. 2549. For nearly the entire life of the Code, courts have approved non-debtor release provisions like this one. So for decades, Chapter 11 of the Code has been understood to grant authority for such releases when appropriate and necessary to the success of the reorganization.[7]

The Court's citations to pre-Bankruptcy Code cases are an off-point deflection and do not account for important and relevant changes made in the current Bankruptcy Code.

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[7] See, *e.g.*, *In re Johns-Manville Corp.*, 68 B. R. 618, 624–626 (Bkrtcy. Ct. SDNY 1986), aff'd, 837 F. 2d 89, 90, 93–94 (CA2 1988); *In re A. H. Robins Co.*, 88 B. R. 742, 751 (ED Va. 1988), aff'd, 880 F. 2d 694, 700–702 (CA4 1989); *UNARCO Bloomington Factory Workers* v. *UNR Industries, Inc.*, 124 B. R. 268, 272, 278–279 (ND Ill. 1990); *In re Drexel Burnham Lambert Group, Inc.*, 960 F. 2d 285, 293 (CA2 1992); *In re Master Mortgage Inv. Fund, Inc.*, 168 B. R. 930, 938 (Bkrtcy. Ct. WD Mo. 1994); *In re Dow Corning Corp.*, 280 F. 3d 648, 653 (CA6); *In re Airadigm Communications, Inc.*, 519 F. 3d 640, 655–658 (CA7 2008); *In re Seaside Engineering & Surveying, Inc.*, 780 F. 3d 1070, 1081 (CA11 2015); *In re Boy Scouts of Am. and Del. BSA, LLC*, 650 B. R. 87, 112, 135–143 (Del. 2023). I could add dozens more citations to this footnote. But the point is clear.

For example, unlike the former Bankruptcy Act of 1898, the modern Bankruptcy Code grants courts jurisdiction over "suits between third parties which have an effect on the bankruptcy estate." *Celotex Corp.* v. *Edwards*, 514 U. S. 300, 307, n. 5 (1995); see 28 U. S. C. §§157(a), 1334(b) (giving bankruptcy courts jurisdiction over any litigation "related to" the bankruptcy).

Under the current Bankruptcy Code, it is well settled that Chapter 11 bankruptcies can and do affect relationships between creditors and non-debtors who are intimately related to the bankruptcy. For example, under the modern Bankruptcy Code, bankruptcy courts routinely use their broad jurisdiction and equitable powers to stay any litigation—even litigation entirely between third parties—that would affect the bankruptcy estate. *Celotex*, 514 U. S., at 308–310.

The longstanding practice of staying litigation that could affect the bankruptcy estate is similar in important respects to non-debtor releases. In each situation, a provision of the Code provides an explicit authority: to stay litigation involving the debtor, §362, and to release claims involving the debtor, §§1123(b)(1), (3). And in each, the bankruptcy court invokes its broad jurisdiction and equitable power to "augment" that authority, extending it to litigation and claims against non-debtors that might have a "direct and substantial adverse effect" on the bankruptcy estate. *Celotex*, 514 U. S., at 303, 310.

In short, the common and long-accepted practice of staying litigation that could affect the bankruptcy estate shows that under the modern Code, bankruptcy courts can and do exercise control over relationships between creditors and non-debtors. The Court's reliance on pre-Code practice is misplaced.[8]

IV

As I see it, today's decision makes little sense legally, practically, or economically. It upends the carefully negotiated Purdue bankruptcy plan and the prompt and substantial recovery guaranteed to opioid victims and creditors. Now the opioid victims and creditors are left holding the bag, with no clear path forward. To reiterate the words of the victims: "Without the release, the plan will unravel," and "there will be no viable path to any victim recovery." Tr. of Oral Arg. 100.

The Court does not say what should happen next. The Court seems to hope that a new deal is possible, with the Sacklers buying off the last holdouts.

But even if it were true that the parties could eventually reach a new deal, that outcome would likely come at a cost. Future negotiations and litigation would mean additional litigation expense that eats away at the recovery that the opioid victims and creditors have already negotiated, as well as years of additional delay even though victims and family members want and need relief *now*.

And more to the point, without non-debtor releases, a new deal will be very difficult to achieve. By eliminating nonconsensual non-debtor releases, today's decision gives every victim and every creditor an absolute right to sue the Sacklers. Some may hold out from any potential future settlement and instead sue because they want to have their day in court to hold the defendants accountable, or because they want to try to hit the jackpot of a large recovery that they can keep all to themselves. Moreover, because every

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[8] The Court insists that pre-Code practice "may inform our work." *Ante*, at 17, n. 6. But pre-Code practice certainly does not play a role when that practice has been superseded by an express provision of the modern Bankruptcy Code.

victim and creditor knows that the Sacklers' resources are limited, they will now have an incentive to promptly sue the Sacklers before others sue. To be sure, the victims and creditors would face an uphill climb in any such litigation, the Bankruptcy Court found, so it may be that no one will succeed in tort litigation against the Sacklers, meaning that no one will get anything. But even if just one of the victims or creditors—say, a State or a group of victims—is successful in a suit against the Sacklers, its judgment "could wipe out all of the collectible Sackler assets," which in turn could also deplete Purdue's estate and leave nothing for any other victim or creditor. *Id.*, at 103. That reality means that everyone has an incentive to race to the courthouse to sue the Sacklers pronto—the classic collective-action problem.

Because some victims or creditors may hold out from any potential future settlement for any one of those reasons and instead still sue, the Sacklers are less likely to settle with anyone in the first place. Maybe the clouds will part. But in a world where nonconsensual non-debtor releases are categorically impermissible, any hope for a new deal seems questionable—indeed, the parties to the bankruptcy label it "pure fantasy." Brief for Debtor Respondents 4.

The bankruptcy system was designed to prevent that exact sort of collective-action problem. Non-debtor releases have been indispensable to solving that problem and ensuring fair and equitable *victim recovery* in multiple bankruptcy proceedings of extraordinary scale—not only opioids, but also many other mass-tort cases involving asbestos, the Boy Scouts, the Catholic Church, silicone breast implants, the Dalkon Shield, and others.

The Court's apparent concern that the Sacklers' settlement payment of $5.5 to $6 billion was not enough should have led at most to a remand on whether the releases were "appropriate" under 11 U. S. C. §1123(b)(6) (if anyone had raised that argument here, which they have not). But instead the Court responds with the dramatic step of repudiating the plan and eliminating non-debtor releases altogether.

The Court's decision today jettisons a carefully circumscribed and critically important tool that bankruptcy courts have long used and continue to need to handle mass-tort bankruptcies going forward. The text of the Bankruptcy Code does not come close to requiring such a ruinous result. Nor does its structure, context, or history. Nor does hostility to the Sacklers—no matter how deep: "Nothing is more antithetical to the purpose of bankruptcy than destroying estate value to punish someone." A. Casey & J. Macey, In Defense of Chapter 11 for Mass Torts, 90 U. Chi. L. Rev. 973, 1017 (2023). Gutting this longstanding bankruptcy court practice is entirely counterproductive, and simply inflicts still more injury on the opioid victims.

Opioid victims and other future victims of mass torts will suffer greatly in the wake of today's unfortunate and destabilizing decision. Only Congress can fix the chaos that will now ensue. The Court's decision will lead to too much harm for too many people for Congress to sit by idly without at least carefully studying the issue. I respectfully dissent.

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Supreme Court Validates "Clarified" *Manville* Insurance Injunction: Channeling… and So Much More!

By Ralph Brubaker

The reorganization proceedings of Johns-Manville Corporation in the 1980s, which dealt with the massive product liability resulting from Manville's manufacture of asbestos products, were historic and monumental and became the template for all subsequent asbestos reorganizations. One of the key features of this reorganization was Manville's coverage settlement with its insurers and the so-called "channeling" injunction entered in implementation thereof. While such an insurance injunction is a species of so-called nondebtor "releases"—an extremely controversial practice of dubious validity—"the insurance injunctions are sui generis"[1] and justifiable as a means of ensuring that the debtor's estate fully realizes upon (and thus equitably distributes the entirety of) a debtor's liability policy proceeds. Moreover, studied observation of Manville's confirmation proceedings and the various opinions approving the Manville "channeling" injunction led to the commonly articulated view that this was its limit—"that the channeling injunction applied only to third parties [who] seek to collect out of the proceeds of Manville's insurance policies on the basis of Manville's conduct."[2]

If you were of the same opinion (and I know I was), the Supreme Court's recent decision in *Travelers Indemnity Co. v. Bailey*[3] may have come as somewhat of a surprise. We were evidently quite mistaken; the Manville channeling injunction also released Travelers Indemnity Company from any and all claims that Travelers is independently liable to asbestos claimants based upon Travelers' own wrongful misconduct. Indeed, it turns out that any such claims against Travelers "'are—and always have been—permanently barred' by the [*Manville* Bankruptcy Court's] 1986 Orders."[4] Who knew?!

How this came to be makes for an interesting tale.

The *Manville* Channeling Injunction

When Manville filed Chapter 11 in 1982, its most valuable remaining asset, particularly given the tidal wave of asbestos suits that had swept it into bankruptcy, was its liability insurance policies. The ultimate value of those policies, however, was subject to a great deal of uncertainty because Manville was engaged in seemingly intractable litigation with its insurance carriers over the scope and limits of the insurance coverage. A corner-

In This Issue

Editor's Note: Cases reviewed in this issue have been reported through July 2009. The Bankruptcy Reform Act of 1978 is referred to herein as the Code; the former Bankruptcy Act is referred to as the Act; the Bankruptcy and Federal Judgeship Act of 1984, Public Law No. 98-353, is referred to as the 1984 Amendments; the Bankruptcy Reform Act of 1994 is referred to as the 1994 Amendments; the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 is referred to herein as the 2005 Amendments.

stone of Manville's ultimate reorganization, therefore, was laid when Manville and its insurers reached a settlement agreement regarding insurer funding for payment of Manville's asbestos liabilities.

Manville's insurance companies agreed to pay $770 million to the Manville bankruptcy estate, which money would fund the Manville Personal Injury Settlement Trust. This settlement was predicated upon the bankruptcy court issuing an injunction that barred suits against the Manville insurers and, in lieu thereof, "channeled" the enjoined claims to the Trust for payment therefrom. The bankruptcy court issued such an injunction both in approving the settlement and in confirming Manville's ensuing plan of reorganization. The court's power to issue the injunction was challenged, though, and the justifications proffered in overruling these objections are telling. Indeed, it was the *Manville* opinions that coined the phrase "equitable channeling injunctions." Bankruptcy Judge Lifland's learned exposition was as follows:

> Injunctions which permit the sale of assets free and clear of third party interests… typically channel the prosecution of those third party interests against the proceeds of the sale. This power to effectuate sales free and clear was recognized by the Supreme Court over 100 years ago.…
>
> Various Code sections, e.g. § 363(f) and (h), explicitly provide for the channeling of claims in this manner. The court's authority to channel claims is, however, by no means limited to such provisions. This authority is "granted by implication", even absent statutory provisions.…
>
> …. Furthermore, these channeling injunctions are inherently equitable, and not creatures unique to the bankruptcy courts.…
>
> The analogy to equitable channeling injunctions is quite compelling in this case. The Injunction sought under the Plan will preserve the rights of all asbestos claimants by establishing a corpus of funds from which all can collect. In the absence of the Injunction, the intended beneficiaries of the reorganization will certainly suffer. Furthermore, in the absence of the Injunction, one of the central purposes of Title 11, i.e. preventing the inequitable, piece-meal dismemberment of the debtor's estate, cannot be achieved. Therefore, this court finds that the Injunction contemplated by the Plan is well within its equitable and statutory authority.[5]

In affirming the propriety of the *Manville* insurance injunction, the Second Circuit's *MacArthur* opinion[6] employed the same reasoning:

> We conclude that the Bankruptcy Court had jurisdiction over the insurance policies as property of the debtor's estate. Moreover, the court had authority to issue the injunctive orders pursuant to its power to dispose of a debtor's property free and clear of third-party interests and to channel such interests to the proceeds of the disposition.[7]
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> * * * *
>
> [Appellant]'s primary objection on appeal is that the Bankruptcy Court lacked jurisdiction and authority to enjoin suits against Manville's insurers. [Appellant] argues that the injunctive orders constitute a *de facto* discharge in bankruptcy of non-debtor parties not entitled to the protection of Chapter 11.… The flaw in [appellant]'s reasoning is that the injunctive orders do not offer the umbrella protection of a discharge in bankruptcy. Rather, they preclude only those suits against the settling insurers that arise out of or relate to Manville's insurance policies. Moreover, claims against the insurers based on Manville's policies are not extinguished; they are simply channeled away from the insurers and redirected at the proceeds of the settlement. The Bankruptcy Court properly issued the orders pursuant to its equitable and statutory powers to dispose of the debtor's property free and clear of third-party interests and to channel those interests to the proceeds thereby created.[8]
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> Having properly exercised jurisdiction over the insurance policies, the Bankruptcy Court

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had the authority to approve the settlements and to channel claims arising under the policies to the proceeds of the settlement.…

The injunctive orders issued by the Bankruptcy Court were necessary to effectuate the Court's channeling authority, that is, to make sure that claims to Manville's insurance proceeds were, in fact, channeled to the settlement fund and could not be asserted directly against the insurers. The authority to issue the injunction is thus a corollary to the power to dispose of assets free and clear and to channel claims to the proceeds.…

Admittedly, the insurance settlement and accompanying injunction in this case are not precisely the same as the traditional sale of real property free and clear of liens followed by a channeling of the liens to the proceeds of the sale. Here, the property of the estate at issue (insurance policies) was not technically "sold"; rather, Manville liquidated its interest via a voluntary settlement. Moreover, the claims on the property… are different from the liens on real property that are traditionally the subject of the bankruptcy court's equitable channeling power. Nevertheless, the underlying principle of preserving the debtor's estate for the creditors and funneling claims to one proceeding in the bankruptcy court remains the same. The principle is a fundamental part of bankruptcy law. Particularly since the insurance settlement/injunction arrangement was essential in this case to a workable reorganization, it falls well within the bankruptcy court's equitable powers….[9]

The Limits of the Channeling Rationale

The modern statutory authority for bankruptcy courts' injunctive powers is section 105(a) of the Bankruptcy Code, which provides that "[t]he court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code. This provision, like its predecessor under the Bankruptcy Act of 1898, gives to federal bankruptcy courts the powers of courts of equity granted to all federal courts in the All Writs Act.[10] The All Writs Act provides that "all courts established by Act of Congress may issue all writs necessary or appropriate *in aid of their respective jurisdictions*,"[11] which includes writs of injunction.[12]

The *Manville* discussions of equitable channeling injunctions centered around the power of a court to effectuate sale of an asset free and clear of liens—a general equitable power that inheres in the federal courts. Thus the federal courts exercised free-and-clear sale powers in equitable receivership proceedings, without any express statutory authority such as that now contained in Code § 363(f).[13] Likewise, federal bankruptcy statutes antedating the Bankruptcy Code contained no free-and-clear sale provision such as § 363(f). Nonetheless, federal bankruptcy courts have always effected free-and-clear sales through their inherent equitable powers.[14] Such a free-and-clear sale effectively enjoins lien claimants from further pursuit of that asset and channels lien claims to the proceeds of the sale, for satisfaction from those proceeds. The Supreme Court has explained this injunctive power as one rooted in notions of exclusive in rem jurisdiction:

> This is but an application of the well recognized rule that when a court of competent jurisdiction takes possession of property through its officers, this withdraws the property from the jurisdiction of all other courts which, though of concurrent jurisdiction, may not disturb that possession; and that the court originally acquiring jurisdiction is competent to hear and determine all questions respecting title, possession and control of that property.[15]

This concept of exclusive jurisdiction applies to an in rem or quasi in rem action to the extent that possession or control of property is necessary for effective relief.[16] When a court exercises such exclusive in rem jurisdiction, "[t]o protect its jurisdiction, that court may issue an injunction."[17]

The general power to prevent interference with exclusive in rem jurisdiction over property by enjoining collateral proceedings is limited to enjoining other in rem actions against that same property.[18] In this way, any such claim against the property can be channeled to the court with exclusive in rem jurisdiction over the property. Equitable channeling of all in rem claims into the court with exclusive jurisdiction over the property in no way prejudices the channeled claims; it simply assures orderly resolution of all conflicting claims to the property.

A collateral in personam suit, though, does not interfere with a court's exclusive in rem control of property. An in personam suit will not establish a plaintiff's claim to any specific property interest but will merely determine the defendant's personal obligations to the plaintiff, irrespective of what assets might be available to satisfy those obligations.[19] Exclusive in rem jurisdiction, therefore, is not a basis on which to enjoin collateral in personam actions.[20]

Federal bankruptcy courts, of course, possess the in rem "exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of" the bankruptcy case.[21] The channeling rationale, however, cannot be used to justify injunctions that would forever bar an action against a nondebtor based on the nondebtor's personal liability to creditors—in personam actions that in no way encroach upon the bankruptcy court's exclusive in rem jurisdiction over the debtor's property. Extinguishing these in personam actions simply cannot be founded upon "the equitable and inherent power to channel claims to a specific *res*,"[22] not even by analogy. Applying the channeling rationale to such an injunction takes a mechanism designed to preserve, consolidate, and resolve all in rem claims and transforms it into a mechanism that forcibly converts creditors' in personam claims against a nondebtor into in rem claims against the debtor's property. In the process, those in personam rights against the nondebtor are extinguished, without any assurance that the substituted in rem rights against the debtor's property are the equivalent of the extinguished in personam rights.[23] Such a drastic alteration of in personam claims against a nondebtor, in the guise of merely protecting the bankruptcy court's exclusive in rem jurisdiction over the debtor's property, is not a proper exercise of traditional in rem channeling powers.

Beyond the Channeling Rationale

After *Manville*, though, other courts seized upon the *Manville* injunction to pave the way for approval of nonconsensual plan of reorganization provisions (misleadingly denominated nondebtor "releases") and entry of permanent injunctions that have, indeed, barred creditors' assertion of direct, independent, in personam claims against nondebtor third parties. For example, in the mass tort bankruptcy of A.H. Robins Company, manufacturer of the Dalkon Shield contraceptive device, the Fourth Circuit affirmed nondebtor "releases" that precluded claimants from suing *anyone* for personal injuries caused by the Dalkon Shield.[24] Beneficiaries of the nondebtor "releases" included Robins' insurer and alleged joint tortfeasor, Aetna,[25] members of the Robins family,[26] and other present and former officers, directors, employees, and attorneys for Robins. Aetna and these individuals were alleged to have participated in efforts to defraud the public in the marketing of the Dalkon Shield and to have used Robins' attorneys to perpetuate and cover up the fraud.[27] The Robins plan of reorganization, confirmed in 1988, discharged all of these individuals from any personal liability, and the Robins nondebtor "releases" even went so far as to preclude injured women from suing their doctors for claims of medical malpractice.[28]

Nondebtor "releases" such as these, however, have been extremely controversial and have provoked sustained critical condemnation, including from this contributing editor.[29] The circuits are split on the propriety of such nondebtor "releases,"[30] but there seems to have been some retrenchment in judicial permissiveness regarding the practice. For example, the Second Circuit's 1992 opinion in the *Drexel Burnham Lambert* bankruptcy[31] was an early post-*Manville* opinion permitting the practice to take root and flourish.[32] More recently, though, the Second Circuit explicitly recognized in the *Metromedia* case[33] that "a nondebtor release is a device that lends itself to abuse" and opined that a nondebtor party's "material contribution" to the debtor's estate was an insufficient basis for permanently enjoining creditors' claims against that nondebtor party.[34] Indeed, the court has said that "[i]t is… 'precisely this conditioning of financial participation by non-debtors on releases that is subject to the sort of abuse foreseen' in *Metromedia*."[35] Likewise, the Third Circuit's opinion in the *Combustion Engineering* asbestos bankruptcy[36] struck down nondebtor "releases" whose scope went beyond that expressly authorized by Code § 524(g) "in a wide-ranging critique of nonconsensual non-debtor 'releases' and permanent injunctions on grounds that apply with full force outside the asbestos context."[37]

Ex Post "Clarification" of the *Manville* Insurance Injunction: More Than Channeling

Over a decade after confirmation of Manville's plan of reorganization, and notwithstanding the 1986 insurance injunction, Manville asbestos claimants began suing Manville's long-time primary insurer, Travelers, alleging that Travelers is directly liability to Manville asbestos claimants on a number of statutory and common law theories, many of which were quite novel and many of which have never been accepted as a matter of state law, but all of which contained similar allegations of wrongful conduct by Travelers: "Travelers acquired knowledge about the dangers of asbestos from claims in the 1950s, recognized the potential for future escalation of asbestos litigation and began to influence Manville's purported failure to disclose knowledge about asbestos hazards."[38]

These claims, however, were clearly outside the channeling rationale used to justify approval of the 1986 insurance injunction, as they were not, in any sense, in rem claims against the Manville "property" at issue in 1986 and protected by the 1986 insurance injunction—Manville's insurance policy proceeds. Rather, they were in personam claims against Travelers based upon Travelers' own alleged misconduct:

> The claims at issue in *MacArthur*… differ significantly from the… claims at issue here. Travelers candidly admits that [these] claims seek damages from Travelers that are *unrelated* to the policy proceeds, quite unlike the claims

> in *MacArthur*… where plaintiffs sought indemnification or compensation for the tortious wrongs of Manville to be paid out of the proceeds of Manville's insurance policies. Moreover, the claims at issue here do not seek to collect on the basis of Manville's conduct. Instead, the Plaintiffs seek to recover directly from Travelers, a non-debtor insurer, for its own alleged misconduct. Plaintiffs neither seek to recover insurance proceeds nor rely on the insurance policies for recovery.[39]

Nonetheless, in 2002, Travelers filed a motion in the bankruptcy court seeking to enjoin 26 of these independent actions pending in various state courts, contending that these suits were barred by the 1986 insurance injunction. The bankruptcy court referred the parties to mediation, which ultimately produced a settlement agreement pursuant to which Travelers would pay $445 million into a settlement fund, contingent upon entry of an order by the bankruptcy court "clarifying" that the suits at issue were and remained prohibited by the 1986 insurance injunction. After extensive hearings and fact finding, the bankruptcy court approved the settlement and entered the requisite "clarifying" order. Various objectors appealed the order, which was affirmed by the district court. The Second Circuit, however, vacated the "clarifying" order, concluding that it went beyond the lawful reach of (and essentially expanded) the original 1986 insurance injunction. The Supreme Court, though, by a seven-justice majority, reversed and reinstated the "clarifying" order.

Nondebtor "Releases," Subject Matter Jurisdiction, and Res Judicata

The Second Circuit's opinion below is quite significant (and should remain so) as the court held that nondebtor "releases" that go beyond the channeling rationale are impermissible: "Instead, a bankruptcy court only has jurisdiction to enjoin claims that directly affect the *res* of the bankruptcy estate."[40] Indeed, this is precisely the view previously advocated by this contributing editor "that non-debtor releases overstep the bounds of limited bankruptcy jurisdiction; bankruptcy judges have *no* jurisdictional authority to approve non-debtor releases, in the absence of express congressional authorization."[41]

The Supreme Court majority in *Travelers* made clear that they were not reversing on that issue, that they were not resolving the circuit split over the propriety of so-called nondebtor "releases," and indeed, that their opinion says nothing about "whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's" rights against the insurers.[42] For the *Travelers* majority, objections to the "clarifying" order were simply a collateral attack on the 1986 insurance injunction, barred by the preclusion principles of res judicata, even if the bankruptcy court was wholly without subject matter jurisdiction to enjoin the claims at issue.

It was "undisputed that the bankruptcy court had continuing jurisdiction to interpret and enforce its own 1986 orders," and there was also "no doubt that the bankruptcy court had jurisdiction to clarify its prior orders."[43] Thus if the bankruptcy court was correct in its determination that the independent suits at issue were barred by the terms of the original 1986 insurance injunction, then it was indeed too late to contend that the 1986 insurance injunction exceeded the permissible scope of a bankruptcy court's injunctive powers—a challenge that could properly be made only by direct appeal from the insurance injunction when issued in 1986.

The Supreme Court's 1938 decision in *Stoll v. Gottlieb* affirmed the preclusive effect of a nondebtor "release" provision in a plan of reorganization, even "assuming the Bankruptcy Court did not have jurisdiction over the subject matter of the order,"[44] and *Travelers* simply reaffirmed that principle.

> Those [1986] orders are not any the less preclusive because the attack is on the Bankruptcy Court's conformity with its subject-matter jurisdiction, for "[e]ven subject-matter jurisdiction… may not be attacked collaterally." So long as respondents or those in privity with them were parties to the Manville bankruptcy proceeding, and were given a fair chance to challenge the Bankruptcy Court's subject matter jurisdiction, they cannot challenge it now by resisting enforcement of the 1986 Orders.[45]

Interpreting the Scope of the 1986 Insurance Injunction

As Justice Stevens' dissent in *Travelers* pointed out, "[t]he Court's holding that respondents' challenge is an impermissible collateral attack is predicated on its determination that the 1986 Insurance Settlement Order plainly enjoined their independent actions" against Travelers.[46] Justice Stevens, though, was of the view that "[i]n challenging the Bankruptcy Court's 2004 order 'clarifying' the scope of the Insurance Settlement Order, respondents were in fact timely appealing an order that *rewrote* the scope of the 1986 injunctions."[47] The real crux of the dispute in *Travelers*, therefore, was interpretation of the scope of the 1986 Manville insurance injunction.

The 1986 insurance settlement order, also incorporated into the order confirming Manville's plan of reorganization, contained three interrelated provisions protecting the insurers from further claims: it "released" insurers from all "Policy Claims," it channeled all "Policy Claims" to the Manville Trust, and it permanently enjoined all persons from commencing or continuing any action on any "Policy Claims" against a settling insurer. The scope of relief afforded to Travelers in 1986, therefore, depends upon the scope of the term, "Policy Claims," which the order defined as:

> any and all claims, demands, allegations, duties, liabilities and obligations (whether or not presently known) which have been, or could have been, or might be, asserted by any Person against any or all members of the [Manville] Group or against any or all members of the Settling Insurer Group *based upon, arising out of or relating to any or all of the Policies*.[48]

Plain Meaning… What Else?

The bankruptcy court, before issuing its "clarifying" order, made extensive factual findings regarding the long history of the relationship between Manville and its primary liability insurer, Travelers, to the effect that "Travelers learned virtually everything it knew about asbestos from its relationship with Manville."[49]

> In short, the evidence adduced… persuasively demonstrates that in connection with its insurance relationship with Manville, Travelers gained knowledge of asbestos and asbestos-related health litigation through its underwriting of the Manville policies, inspection of Manville plants, investigation of asbestos-related claims against Manville, defense of lawsuits against Manville, and negotiation of settlements of asbestos-related lawsuits against Manville.[50]

This, the bankruptcy court found, was sufficient to conclude that the independent suits at issue against Travelers were for claims "based upon, arising out of, or relating to any or all of the Policies" within the meaning of the 1986 insurance injunction.

> The evidence in this proceeding establishes that the gravamen of [the independent claims at issue against Travelers] were acts or omissions by Travelers arising from or relating to Travelers['] insurance relationship with Manville. Thus, claims against Travelers based on such actions or omissions necessarily "arise out of" and [are] "related to" the Policies… [T]he factual allegations against Travelers "inescapabl[y]" relate to its relationship with Manville.[51]

The *Travelers* majority agreed with this conclusion, holding that "where the plain terms of a court order unambiguously apply, as they do here, they are entitled to their effect."[52] Justice Stevens, however, thought that "[t]he Court doth protest too much."[53] Indeed, the *Travelers* majority acknowledged (and simply dismissed) facial indications that the language at issue was indeed ambiguous (as to either its intended or perceived linguistic meaning) and intractably vague in a manner that necessarily invoked a legal construction of the scope of the language.

Does "the Policies" Refer to Legal Rights Thereunder or Insurer-Insured Interactions?

One possible meaning that could be attributed to the operative language used to define "Policy Claims" is that "claims… based upon, arising out of or relating to… the Policies" is referring to the legal rights and duties established by the insurance policies. Indeed, this interpretation is quite compelling since it limits the scope of the insurance injunction in a manner that fully reconciles it with the channeling rationale that the bankruptcy court originally proffered to justify entry of the insurance injunction in 1986.

The *Travelers* majority acknowledged, but inexplicably minimized and summarily dismissed, this entirely (and perhaps even more) plausible interpretation of "Policy Claims" as follows:

> Although it would be possible (albeit quite a stretch) to suggest that a "claim" only relates to Travelers' insurance coverage if it seeks recovery based upon Travelers' specific contractual obligation to Manville, "allegations" is not even remotely amenable to such a narrow construction and clearly reaches factual allegations that relate in a more comprehensive way to Travelers' dealings with Manville.[54]

However, why an "allegation… based upon, arising out of or relating to… the Policies" must mean an allegation regarding "dealings" between insurer and insured "in a more comprehensive way" than an allegation regarding the legal rights and duties established by the terms of "the Policies" is not at all apparent. The Court seems to have simply resorted to ipse dixit reasoning to ignore manifest ambiguity that, if acknowledged, would likely lead to an interpretation at odds with that favored by the Court (for unarticulated reasons).

An Abstract General Interpretation Inevitably Produces Intractable Vagueness

If we accept the very broad, general interpretation of "Policy Claims" favored by the *Travelers* majority, we immediately recognize that it is hopelessly vague in its application. Under this broad, general interpretation, as the Second Circuit noted, "[t]here is little doubt that, in a literal sense, the instant claims against Travelers 'arise out of' its provision of insurance coverage to Manville."[55] The problem with this broad, general interpretation, though, is that it also sweeps in claims that clearly were never intended to be part of the insurance injunction. Justice Stevens gave the following example:

> Presumably, for instance, the Court would not deem enjoined a state-law claim for personal injuries caused by a Travelers' agent's reckless driving while en route to the courthouse to defend Manville even though, in a literal sense, this suit relates to (perhaps even arises out of) Travelers' performance of its policy obligations to Manville.[56]

Indeed, the *Travelers* majority acknowledged the inescapable vagueness implicit in its interpretation of "Policy Claims," quoting Justice Scalia's observation that "[a]pplying the 'relate to' provision according to its terms [i]s a project doomed to failure, since, as many a curbstone philosopher has observed, everything is related to everything else."[57] An interpretation that favors a meaning that is hopelessly vague inevitably involves a further legal construction of some sort that permits principled resolution of the vagueness. Again, the *Travelers* majority acknowledged this: "There is, of course, a cutoff at some point, where the connection between the insurer's action complained of and the insurance coverage would be thin to the point of absurd."[58] The Court, however, supplied no principled means for resolving the vagueness other than the equivalent of "we know it when we see it": "These actions so clearly involve 'claims' (and, all the more so, 'allegations') 'based upon, arising out of or relating to' Travelers' insurance coverage of Manville, that we have no need here to stake out the ultimate bounds of the injunction."[59]

In other words, an ipse dixit interpretation of "Policy Claims" produces a hopelessly vague meaning resolved by an ipse dixit construction. Of course, the advantage of proceeding in this manner is that the Court need not reveal the reasons for its ultimate conclusion that the independent actions at issue should be considered barred by the original 1986 insurance injunction (whatever they are, and we could likely speculate at length). However, if one attempts a more transparent method for interpretation of "Policy Claims," for example, by focusing on indications of its intended or perceived meaning in 1986, or alternatively, a more principled rule of construction to resolve ambiguity, one discovers a number of embarrassments for the decision of the *Travelers* majority.

Contemporaneous Indications of Intended and Perceived Meaning

One difficulty that the *Travelers* majority avoided by its ipse dixit declaration of unambiguous "plain meaning" is determining the proper reference point for determining the linguistic meaning of the language at issue. The bankruptcy court stated that "[a]ny purported arguments based on statements of the parties during the settlement drafting process or otherwise are… completely beside the point."[60] This is not necessarily true, though, since the orders at issue involved both an order approving a settlement, in the nature of an agreed order or consent decree, which was also incorporated into the order confirming the debtor's plan of reorganization.

"In interpreting a confirmed plan, courts use contract principles, since the plan is effectively a new contract between the debtor and its creditors."[61] Moreover, the Supreme Court has stated that the same is true for consent decrees implementing an agreement of the parties:

> [S]ince consent decrees and orders have many of the attributes of ordinary contracts, they should be construed basically as contracts….
>
> Since a consent decree or order is to be construed for enforcement purposes basically as a contract, reliance upon certain aids to construction is proper, as with any other contract. Such aids include the circumstances surrounding the formation of the consent order…. "Assuming that a consent decree is to be interpreted as a contract, it would seem to follow that evidence of events surrounding its negotiation and tending to explain ambiguous terms would be admissible in evidence."[62]

If we acknowledge ambiguity in the language employed to define the operative term "Policy Claims" in *Travelers*, then "the search for meaning begins with the meaning attached by [the] parties to the contract language."[63] "The concern of a court is… with the expectations that it aroused in the parties. It is therefore to these expectations… that we must turn in the search for the meaning of the contract language."[64] When we direct our attention to this inquiry in *Travelers*, every indication is that the parties fully expected the reach of the 1986 insurance injunction to be limited to the channeling rationale.

The most relevant contextual circumstance surrounding entry of the 1986 insurance injunction was this: the extant legal landscape was such that it was virtually unthinkable, at the time, that a bankruptcy court could enter an order discharging the in personam liability of a nondebtor party to a debtor's creditors. Indeed, there was Second Circuit precedent affirmatively prohibiting the practice,[65] and the Supreme Court had stated, only months before, that "parties who choose to resolve litigation through settlement may not dispose of the claims of a third party… without that party's agreement."[66] It was not until the Fourth Circuit's 1989 decision in the A.H. Robins reorganization[67] that we entered the "brave new world" of nonconsensual "releases" of nondebtors' in personam liability for their own alleged misconduct. Consequently, in 1986, neither Manville nor Travelers made any contention that the scope of the Manville insurance injunction should or would exceed the bounds of the in rem channeling rationale. Indeed, precisely the opposite was the case; each of them made contemporaneous representations that the scope of the Manville insurance injunction would be limited to the in rem channeling rationale, which Justice Stevens pointed out in his *Travelers* dissent:

> That the Bankruptcy Court was without authority to enjoin independent actions was well understood by both Manville and Travelers during their settlement negotiations. In Manville's memorandum in support of the Insurance Settlement Agreement, it clarified that it did "not seek to have the [Bankruptcy] Court release its Settling Insurer from claims by third parties based on the Insurers's own tortious misconduct towards the third party" but rather sought only to release the insurers "from the rights Manville might itself have against them or rights derivative of Manville's rights under the policies being compromised or settled." This understanding reflected not only the basic fact that the settlement was between Manville and its insurers (and not third parties), but also the parties' knowledge that the "Second Circuit [had held] that the bankruptcy courts lack power to discharge 'independent' claims of third parties against nondebtors."
>
> Travelers similarly acknowledged the limits of the Bankruptcy Court's power. Noting that "[t]he court has *in rem* jurisdiction over the Policies and thus the power to enter appropriate orders to protect that jurisdiction," it stated that "the injunction is intended only to restrain claims against the res (i.e., the Policies) which are or may be asserted against the Settling Insureres."… see also… (memorandum of the legal representative [for asbestos claimants] noting that "[a]ll parties seem to agree that any injunction, channeling order and release is limited to this Court's jurisdiction over the *res*"). In short, it was apparent to the settling parties, and no doubt also to the Bankruptcy Court, that the court lacked the power to enjoin [in personam] third-party claims against nondebtors….[68]

Indeed, the opinions of both the bankruptcy court and the Second Circuit approving the 1986 insurance injunction, quoted extensively above, are fully consistent with this understanding of the limited scope of the injunction.

A Rule of Construction That Favors Lawful, Permissible Judicial Relief Over Unlawful and Impermissible

"To be sure, a federal court is more than 'a recorder of contracts' from whom parties can purchase injunctions; it is 'an organ of government constituted to make judicial decisions.'"[69] Thus the intention of the court in entering even an agreed order is also relevant in interpreting its meaning. Of course, the contemporaneous evidence in the form of the bankruptcy court's legal justification for the 1986 insurance injunction indicates that the court intended the scope of the injunction to be limited by the in rem channeling rationale articulated at the time. Nonetheless, when subsequently asked to "clarify" the scope of the 1986 insurance injunction, the bankruptcy court elaborated its intention as follows: "The Court's repeated use of the terms 'arising out of' and 'related to' were not gratuitous or superfluous; they were meant to provide the broadest protection possible to facilitate global finality for Travelers as a necessary condition for it to make a significant contribution to the Manville estate."[70] "The Court did not intend the scope of finality of the Orders to be less than 100% of everything Manville-related."[71]

While this intention would support interpreting the scope of "Policy Claims" using the broadest general meaning attributable to claims "arising out of" or "related to" the insurance policies, it simply reintroduces the intractable vagueness of this broad interpretation in its application. Did the bankruptcy court really intend the injunction to bar the car-crash suit from Justice Stevens' hypothetical? If not (which is surely the case), there is inevitably a further process of judicial construction necessary to resolve the vagueness, and neither the Bankruptcy Court nor the *Travelers* majority directly confronted this task.

Both the Second Circuit and Justice Stevens, though, proffered an eminently reasonable rule of construction, which likely accords fully with the bankruptcy court's intention in ordering "the broadest protection possible"—we should presume that a court did not (because, in a very real sense, it could not) order relief outside of its subject matter jurisdiction. After all, "a consent decree must spring from and serve to resolve a dispute within the court's subject-matter jurisdiction."[72] As Justice Stevens put it:

> If the definition of the term "Policy Claims" is not amenable to a purely literal construction and the Court must look beyond the four corners of the Insurance Settlement Order to ascertain its meaning, however, the Bankruptcy Court's factual findings in 2004 are not the best guide. I would instead construe the order with reference to the limits of the Bankruptcy Court's authority—limits that were well understood by the insurers during the original settlement negotiations….
>
> We should not lightly assume that the Bankruptcy Court entered an order that exceeded its authority.… Thus, even accepting the Bankruptcy Court's representation in 2004 that it had 'meant to provide the broadest protection possible" to the settling insurers, such relief could not include protection from independent actions.[73]

Expediency Rules the Day

Given the many indications that the scope of the 1986 Manville insurance injunction was, indeed, originally intended and fully understood by all to be limited to its in rem channeling rationale, it is rather troubling that the Supreme Court went out of its way to ensure otherwise, through a decision that contained no novel or even important "legal" rulings. Indeed, given the prevailing assumption that the scope of the 1986 insurance injunction was so limited, the subsequent invocation of seemingly benign preclusion doctrine in fact works a manifest injustice on the plaintiffs, as Justice Stevens explained:

> In challenging the Bankruptcy Court's 2004 order "clarifying" the scope of the Insurance Settlement Order, respondents were in fact timely appealing an order that *rewrote* the scope of the 1986 injunctions. Their objection could not have been raised on direct appeal of the 1986 order because it was not an objection to anything in that order. And, of course, the Court of Appeals did not rule on a challenge to the enjoining of independent actions during direct review, as the Court acknowledges. To the contrary, it interpreted the 1986 order as reaching only [in rem] insurer actions. Thus, there neither was nor reasonably could have been a prior challenge that the 1986 order impermissibly enjoined independent actions.[74]

Justice Stevens essentially alleged that the bankruptcy court had, in fact, become "'a recorder of contracts' from whom parties can purchase injunctions":[75]

> [I]t is worth asking why Travelers paid more than $400 million in 2004 to three new settlement funds in exchange for the Bankruptcy Court's order "clarifying" that the independent actions "are—and always have been—permanently barred" by the 1986 injunction. If the 1986 injunction were as clear as the Court assumes, surely Travelers would not have paid $445 million—more than five times the amount of its initial contribution to the Manville Trust—to obtain a redundant piece of paper.[76]

One suspects that the decision was, in large part, simply a reaction to the questionable validity and growing numerosity of the plaintiffs' claims at issue. A facile preclusion decision presented an expedient antidote to frustrations inherent in our federalist system of dispute resolution. Indeed, the Second Circuit noted the dilemma:

> The irony in all of this is that while the [plaintiffs' independent actions] involve a claim of an independent duty on the part of Travelers, they have met with almost universal failure in the state courts. Thus, while the bankruptcy court's order sought to achieve one-stop relief for Travelers that could be seen as well deserved, it seems to us there is not one but many courthouses where the legitimacy of these actions must be tested. The bankruptcy court's desire to facilitate global finality for Travelers may not be used as a jurisdictional bootstrap when no jurisdiction otherwise exists.[77]

The Supreme Court obviously disagreed.

1. Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, 1997 U. Ill. L. Rev. 959, 961.
2. In re Combustion Engineering, Inc., 391 F.3d 190, 235 n.47, 43 Bankr. Ct. Dec. (CRR) 271, Bankr. L. Rep. (CCH) P 80206 (3d Cir. 2004), as amended, (Feb. 23, 2005). Indeed, the scope of any insurance injunction expressly authorized in asbestos bankruptcies by Code § 524(g), which was modeled upon and intended to retroactively validate the *Manville* injunction, is clearly limited in this fashion. See 11 U.S.C.A. § 524(g)(4)(A)(ii)(III).
3. Travelers Indem. Co. v. Bailey, 129 S. Ct. 2195, Bankr. L. Rep. (CCH) P 81505 (2009).
4. Travelers, 129 S.Ct. at 2200 (quoting bankruptcy court opinion).
5. Matter of Johns-Manville Corp., 68 B.R. 618, 625-26, 15 Bankr. Ct. Dec. (CRR) 480, 16 Collier Bankr. Cas. 2d (MB) 98, Bankr. L. Rep. (CCH) P 71531 (Bankr. S.D. N.Y. 1986), aff'd, 78 B.R. 407 (S.D. N.Y. 1987), order aff'd, 843 F.2d 636, 17 Bankr. Ct. Dec. (CRR) 695, Bankr. L. Rep. (CCH) P 72264 (2d Cir. 1988).
6. MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 17 Bankr. Ct. Dec. (CRR) 293, 18 Collier Bankr. Cas. 2d (MB) 316, Bankr. L. Rep. (CCH) P 72180 (2d Cir. 1988).
7. MacArthur, 837 F.2d at 90.
8. MacArthur, 837 F.2d at 91.

9. MacArthur, 837 F.2d at 93-94 (citations omitted).

10. Legislative history makes this clear:

> Section 105 is similar in effect to the All Writs Statute, 28 U.S.C. § 1651... The section is repeated here for the sake of continuity from current law and ease of reference, and to cover any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs Statute.

H.R. Rep. No. 95-595, at 316-17 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6273-74; see also Steelman v. All Continent Corp., 301 U.S. 278, 288-89, 57 S. Ct. 705, 81 L. Ed. 1085 (1937); Continental Illinois Nat. Bank & Trust Co. of Chicago v. Chicago, R.I. & P. Ry. Co., 294 U.S. 648, 675-76, 55 S. Ct. 595, 79 L. Ed. 1110 (1935).

11. 28 U.S.C.A. § 1651(a) (emphasis added).

12. See Ralph Brubaker, Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten *Callaway v. Benton* Case, 72 Am. Bankr. L.J. 1, 14-15 (1998).

13. See Riverdale Cotton Mills v. Alabama & Georgia Mfg Co, 198 U.S. 188, 25 S. Ct. 629, 49 L. Ed. 1008 (1905); Julian v. Central Trust Co., 193 U.S. 93, 24 S. Ct. 399, 48 L. Ed. 629 (1904); First Nat Bank of Cleveland, Ohio v. Shedd, 121 U.S. 74, 7 S. Ct. 807, 30 L. Ed. 877 (1887); Mellen v. Moline Malleable Iron Works, 131 U.S. 352, 9 S. Ct. 781, 33 L. Ed. 178 (1889).

14. See Van Huffel v. Harkelrode, 284 U.S. 225, 52 S. Ct. 115, 76 L. Ed. 256, 78 A.L.R. 453 (1931) (1898 Act); Ray v. Norseworthy, 90 U.S. 128, 23 L. Ed. 116, 1874 WL 17473 (1874) (1867 Act); Houston v. City Bank of New Orleans, 47 U.S. 486, 6 How. 486, 12 L. Ed. 526, 1848 WL 6442 (1848) (1841 Act).

15. Isaacs v. Hobbs Tie & Timber Co., 282 U.S. 734, 737-38, 51 S. Ct. 270, 75 L. Ed. 645 (1931).

16. See Penn General Casualty Co. v. Commonwealth of Pennsylvania ex rel. Schnader, 294 U.S. 189, 195, 55 S. Ct. 386, 79 L. Ed. 850 (1935). This would include proceedings to "enforce liens against specific property, to marshall assets, administer trusts, or liquidate insolvent estates," Kline v. Burke Const. Co., 260 U.S. 226, 232, 43 S. Ct. 79, 67 L. Ed. 226, 24 A.L.R. 1077 (1922), and the common law precursor to modern bankruptcy reorganization proceedings, "suits in equity for the control by receivership of the assets of an insolvent corporation." Penn Gen. Cas., 294 U.S. at 195.

17. Ex parte Baldwin, 291 U.S. 610 (1934).

18. See Penn Gen. Cas., 294 U.S. at 195.

19. See Kline v. Burke Constr., 260 U.S. at 230 ("a controversy is not a thing, and a controversy over a mere question of personal liability does not involve the possession or control of a thing"). Indeed, in the equitable receivership context, mere liquidation of a claim against the debtor by reduction to judgment (as opposed to collection of the claim) in collateral proceedings was not considered an action that impaired the exclusive in rem jurisdiction of the federal receivership court. See Riehle v. Margolies, 279 U.S. 218, 223-25, 49 S. Ct. 310, 73 L. Ed. 669 (1929); Ralph Brubaker, An Administrative Expense Odyssey, 29 Bankr. L. Letter No. 6, June 2009, at 1, 6-9.

20. See, e.g., U.S. v. Ford Motor Co., 522 F.2d 962, 965 (6th Cir. 1975); Signal Properties, Inc. v. Farha, 482 F.2d 1136, 1136-37 (5th Cir. 1973); Hyde Const. Co. v. Koehring Co., 388 F.2d 501, 508-09 (10th Cir. 1968); Hemmerick v. Chrysler Corp., 769 F. Supp. 525, 531-32 (S.D. N.Y. 1991), aff'd, 952 F.2d 393 (2d Cir. 1991); cf. State Farm Fire & Cas. Co. v. Tashire, 386 U.S. 523, 533-37, 87 S. Ct. 1199, 18 L. Ed. 2d 270 (1967) (federal statutory interpleader proceedings initiated by insurer to resolve all claims to insurance "fund" could not support enjoining collateral in personam suits by injured parties against insured and codefendants).

21. 28 U.S.C.A. § 1334(e)(1).

22. In re A.H. Robins Co., Inc., 88 B.R. 742, 754 (E.D. Va. 1988), order aff'd, 880 F.2d 694, 19 Bankr. Ct. Dec. (CRR) 997, Bankr. L. Rep. (CCH) P 72955 (4th Cir. 1989).

23. See In re Forty-Eight Insulations, Inc., 133 B.R. 973, 976, 22 Bankr. Ct. Dec. (CRR) 497, 25 Collier Bankr. Cas. 2d (MB) 1629, Bankr. L. Rep. (CCH) P 74365 (Bankr. N.D. Ill. 1991), aff'd, 149 B.R. 860 (N.D. Ill. 1992) (rejecting mysterious channeling argument, because it would extinguish nondebtor claims).

24. See In re A.H. Robins Co., Inc., 131 B.R. 292, 294-96 (E.D. Va. 1991), rev'd, 972 F.2d 77 (4th Cir. 1992) (quoting plan of reorganization's nondebtor "release" and injunction provisions); In re A.H. Robins Co., Inc., 88 B.R. 742, 751-54 (E.D. Va. 1988), order aff'd, 880 F.2d 694, 19 Bankr. Ct. Dec. (CRR) 997, Bankr. L. Rep. (CCH) P 72955 (4th Cir. 1989) (confirming plan of reorganization).

25. Aetna was the subject of a class action suit by Dalkon Shield claimants. See In re A.H. Robins Co., Inc., 85 B.R. 373 (E.D. Va. 1988), aff'd, 880 F.2d 709, 13 Fed. R. Serv. 3d 1239 (4th Cir. 1989) (abrogated by, Amchem Products, Inc. v. Windsor, 521 U.S. 591, 117 S. Ct. 2231, 138 L. Ed. 2d 689, 37 Fed. R. Serv. 3d 1017, 28 Envtl. L. Rep. 20173 (1997)). The personal injury claimants asserted that both Aetna and Robins affirmatively concealed from the public the dangers of the Dalkon Shield. See Richard B. Sobol, Bending the Law: The Story of the Dalkon Shield Bankruptcy 116 (1991).

26. Along with Aetna, these Robins family members were also defendants in the Dalkon Shield claimants' class action suit. See Robins, 85 B.R. at 375.

27. See Sobol, Bending the Law at 220.

28. See In re A.H. Robins Co., Inc., 131 B.R. 292 (E.D. Va. 1991), rev'd, 972 F.2d 77 (4th Cir. 1992) (interpreting scope of nondebtor "releases" as applied to medical malpractice claims).

29. See, e.g., Brubaker, Bankruptcy Injunctions, 1997 U. Ill. L. Rev. 959; Brubaker, Nondebtor Releases and Injunctions, 72 Am. Bankr. L.J. 1; Ralph Brubaker, Unwrapping Prepackaged Asbestos Bankruptcies (Part I): Non-Debtor "Releases" and Permanent Injunctions, 25 Bankr. L. Letter No. 1, Jan. 2005, at 1.

30. The Second, Fourth, and Sixth Circuits have been the most liberal in permitting approval of nondebtor "releases." The Fifth, Ninth, and Tenth Circuits, however, have held that nondebtor "releases" and injunctions are prohibited by Code § 524(e), which provides that "discharge of a debt of the debtor does not affect the liability of any other entity on… such debt." See Brubaker, 25 Bankr. L. Letter No. 1, at 4.

31. In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 288-89, 293, 26 Collier Bankr. Cas. 2d (MB) 1413, 22 Fed. R. Serv. 3d 1091 (2d Cir. 1992).

32. See Brubaker, 1997 U. Ill. L. Rev. at 961-65.

33. In re Metromedia Fiber Network, Inc., 416 F.3d 136, 44 Bankr. Ct. Dec. (CRR) 276, 54 Collier Bankr. Cas. 2d (MB) 1033, Bankr. L. Rep. (CCH) P 80397 (2d Cir. 2005).

34. Metromedia, 416 F.3d at 142, 143. The Seventh Circuit has also recently cast its lot with those circuits willing to permit non-

debtor "releases" and permanent injunctions in "appropriate" circumstances (see In re Airadigm Communications, Inc., 519 F.3d 640, 655-58, 49 Bankr. Ct. Dec. (CRR) 179, Bankr. L. Rep. (CCH) P 81123 (7th Cir. 2008)) but has "preached caution" (In re Ingersoll, Inc., 562 F.3d 856, 51 Bankr. Ct. Dec. (CRR) 133, Bankr. L. Rep. (CCH) P 81469 (7th Cir. 2009)). Permitting the practice while "preaching caution," though, is simply extreme naivete if the hope is that this will exert any appreciable measure of restraint at all. The dynamics of the context in which nondebtor "releases" are bargained for and approved ensure that even the most stringent "necessity" standard will not provide principled limits on the practice. See Brubaker, 1997 U. Ill. L. Rev. at 1018-33.

35. Manville, 517 F.3d at 66 (quoting In re Karta Corp., 342 B.R. 45, 55 (S.D. N.Y. 2006)).

36. In re Combustion Engineering, Inc., 391 F.3d 190, 224-38, 43 Bankr. Ct. Dec. (CRR) 271, Bankr. L. Rep. (CCH) P 80206 (3d Cir. 2004), as amended, (Feb. 23, 2005).

37. Brubaker, 25 Bankr. L. Letter No.1, at 7.

38. In re Johns-Manville Corp., 2004 WL 1876046, *20 (Bankr. S.D. N.Y. 2004), aff'd in part, vacated in part, 340 B.R. 49 (S.D. N.Y. 2006), order vacated, 517 F.3d 52, 49 Bankr. Ct. Dec. (CRR) 144, Bankr. L. Rep. (CCH) P 81107 (2d Cir. 2008), cert. granted, 129 S. Ct. 761, 172 L. Ed. 2d 752 (2008) and cert. granted, 129 S. Ct. 762, 172 L. Ed. 2d 752 (2008) and rev'd and remanded, 129 S. Ct. 2195, Bankr. L. Rep. (CCH) P 81505 (2009).

39. Manville, 517 F.3d at 63 (citations omitted).

40. Manville, 517 F.3d at 66.

41. Brubaker, 1997 U. Ill. L. Rev. at 966.

42. Travelers, 129 S.Ct. at 2207.

43. Travelers, 129 S.Ct. at 2202 (quoting Manville, 517 F.3d at 60-61).

44. Stoll v. Gottlieb, 305 U.S. 165, 171, 59 S. Ct. 134, 83 L. Ed. 104 (1938).

45. Travelers, 129 S.Ct. at 2205-06 (citations omitted). As the Court noted, though, one of the "rare situations in which subject-matter jurisdiction is subject to collateral attack" is pursuant to the authority of Kalb v. Feuerstein, 308 U.S. 433, 60 S. Ct. 343, 84 L. Ed. 370 (1940). Travelers, 129 S.Ct. at 2206 n.6. The Supreme Court in *Kalb*, in interpreting an early statutory version of bankruptcy's automatic stay, explained that such a federal statutory injunction "withdraw[s] from all other courts all power under any circumstances to maintain and enforce [stayed] proceedings," the effect of which is to "render judicial acts taken with respect to the person or property of a debtor whom the bankruptcy law protects nullities and vulnerable collaterally." Kalb, 308 U.S. at 439. The same principle is applicable to suits in violation of the statutory discharge injunction of Code § 524(a). See Ralph Brubaker, Of State Sovereign Immunity and Prospective Remedies: The Bankruptcy Discharge as Statutory *Ex parte Young* Relief, 76 Am. Bankr. L.J. 461, 526-27 (2002). The rationale for this more limited "notion that subject matter jurisdiction is subject to collateral attack" is "to vindicate federal authority over a particular controversy" "on the basis of specific congressional legislation limiting the adjudication of certain matters to federal court." David L. Shapiro, Civil Procedure: Preclusion in Civil Actions 143, 27 (2001). See also Restatement (Second) of Judgments § 12 (2) (collateral attack on subject-matter jurisdiction is permitted if "[a]llowing the judgment to stand would substantially infringe the authority of another tribunal or agency of government").

46. Travelers, 129 S.Ct. at 2212 (Stevens, J., dissenting).

47. Travelers, 129 S.Ct. at 2212 (Stevens, J., dissenting).

48. Manville, 2004 WL 1876046 at *15-*16 (emphasis added).

49. Manville, 2004 WL 1876046 at *13.

50. Manville, 2004 WL 1876046 at *13.

51. Manville, 2004 WL 1876046 at *32.

52. Travelers, 129 S.Ct. at 2204.

53. Travelers, 129 S.Ct. at 2209 (Stevens, J., dissenting).

54. Travelers, 129 S.Ct. at 2203.

55. Manville, 517 F.3d at 67.

56. Travelers, 129 S.Ct. at 2209-10 (Stevens, J., dissenting).

57. Travelers, 129 S.Ct. at 2203.

58. Travelers, 129 S.Ct. at 2203.

59. Travelers, 129 S.Ct. at 2203.

60. Manville, 2004 WL 1876046 at *30 n.6.

61. In re Dow Corning Corp., 456 F.3d 668, 676, 46 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 80664, 2006 FED App. 0260P (6th Cir. 2006), cert. denied, 549 U.S. 1317, 127 S. Ct. 1874, 167 L. Ed. 2d 385 (2007).

62. U. S. v. ITT Continental Baking Co., 420 U.S. 223, 236-38 & n.11, 95 S. Ct. 926, 43 L. Ed. 2d 148, 1975-1 Trade Cas. (CCH) ¶ 60164 (1975).

63. E. Allan Farnsworth, Contracts § 7.9, at 445 (4th ed. 2004).

64. Farnsworth, § 7.7, at 440.

65. In re Nine North Church Street, 82 F.2d 186, 188-89 (C.C.A. 2d Cir. 1936). See also Brubaker, 1997 U. Ill. L. Rev. at 1053 & n.353.

66. Local No. 93, Intern. Ass'n of Firefighters, AFL-CIO C.L.C. v. City of Cleveland, 478 U.S. 501, 529, 106 S. Ct. 3063, 92 L. Ed. 2d 405, 41 Fair Empl. Prac. Cas. (BNA) 139, 40 Empl. Prac. Dec. (CCH) P 36200 (1986).

67. In re A.H. Robins Co., Inc., 880 F.2d 694, 700-02, 19 Bankr. Ct. Dec. (CRR) 997, Bankr. L. Rep. (CCH) P 72955 (4th Cir. 1989).

68. Travelers, 129 S.Ct. at 2210-11 (Stevens, J., dissenting) (citations omitted).

69. Local No. 93, 478 U.S. at 525.

70. Manville, 2004 WL 1876046 at *31.

71. Manville, 2004 WL 1876046 at *30.

72. Local No. 93, 478 U.S. at 525.

73. Travelers, 129 S.Ct. at 2210 (Stevens, J., dissenting) (citations omitted).

74. Travelers, 129 S.Ct. at 2212 (Stevens, J., dissenting) (citation omitted).

75. Local No. 93, 478 U.S. at 525.

76. Travelers, 129 S.Ct. at 2212 (Stevens, J., dissenting) (citation omitted).

77. Manville, 517 F.3d at 68.

Bankruptcy Law Letter

Vol. 23, No. 6 **June 2003**

Supreme Court Decides That a General Release of Claims in a Settlement Agreement Does Not Release Claims of Nondischargeability of the Settlement Debt

In *Archer v. Warner*, 123 S.Ct. 1462 (2003), *rev'g* 283 F.3d 230 (4th Cir. 2002) (discussed in the June 2002 *Bankruptcy Law Letter*, at 6-8), Justice Breyer's majority opinion summarized the issue presented as follows:

> (1) *A* sues *B* seeking money that (*A* says) *B* obtained through fraud; (2) the parties settle the lawsuit and release claims; (3) the settlement agreement does not resolve the issue of fraud, but provides that *B* will pay *A* a fixed sum; (4) *B* does not pay the fixed sum; (5) *B* enters bankruptcy; and (6) *A* claims that *B*'s obligation to pay the fixed settlement sum is nondischargeable because, like the original debt, it is for "money…obtained by…fraud."

Id. at 1465 (quoting Bankruptcy Code § 523(a)(2)(A)). "Can this language [of Code § 523(a)(2)(A)] cover a debt embodied in a settlement agreement that settled a creditor's earlier claim 'for money…obtained by…fraud'?" *Id.* By a 7-2 margin, the Court held that the earlier settlement and release of *A*'s fraud claim did not preclude a subsequent assertion by *A* in *B*'s bankruptcy proceedings that the settlement debt itself is nondischargable because it too was "obtained by" the very same alleged fraud that produced the settlement (in which *A* agreed to forever *release* the fraud claim). At the risk of simply watching this dog chase its tail some more, perhaps some further detail on the *Archer v. Warner* dispute is in order. [See Norton Bankr. L. & Prac. 2d §§ 47:14-47:16; Bankr Serv., L Ed §§ 10A:87-10A:91; Bankr. Desk Guide §§ 35:87-35:91.]

In late 1991, Leonard and Arlene Warner bought the Warner Manufacturing Company for $250,000, and about six months later, in 1992, the Warners sold this business to Elliot and Carol Archer for $610,000. Later that same year, though, the Archers sued the Warners in North Carolina state court alleging, inter alia, fraud in

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In This Issue

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Editor's Note: Cases reviewed in this issue have been reported through May 2003. The Bankruptcy Reform Act of 1978 is referred to herein as the Code; the former Bankruptcy Act is referred to as the Act; the Bankruptcy and Federal Judgeship Act of 1984, Public Law No. 98-353, is referred to as the 1984 Amendments; the Bankruptcy Reform Act of 1994 is referred to as the 1994 Amendments.

it would be inappropriate to *presume* that was the parties' intent, based solely upon the settlement agreement and the Archers' general release of "all claims" against the Warners: "[W]hat has *not* been established here…is that the parties meant to resolve the *issue* of fraud…for purposes of a later claim of nondischargeability in bankruptcy." 123 S.Ct. at 1467. The default rule established by *Archer v. Warner*, then, is that when a settling creditor executes a general release of "all claims" against a debtor, unless the parties specifically agree otherwise, we should presume that the parties did *not* intend for the creditor's release to waive any claim that the debtor's obligations under the settlement agreement are nondischargeable in bankruptcy. And this default rule seems much more likely to reflect the bargain the parties actually struck (or would have had they specifically addressed the issue) than the default rule proffered by Justice Thomas.

As is typical, the release in *Archer v. Warner* was of "all claims" by the Archers against the Warners, *except* those relating to the Warners' obligation to pay the settlement debt itself. All the Archers were attempting to do in raising nondischargeability was *enforce the settlement debt* against the Warners. They did "not assert a new ground for recovery, nor" did they "attack the validity of the prior" agreement. *Brown v. Felsen*, 442 U.S. at 133. The settlement agreement itself expressly left open any determination as to whether the resulting debt was on account of any fraudulent conduct by the Warners. As was the case in *Brown v. Felsen*, the very purpose of the prior settlement was to avoid and forestall any inquiry into the whether the debtors actually engaged in fraud. It was Mrs. Warner, however, who necessitated the subsequent inquiry into her conduct, by failing to pay the settlement debt as agreed. "By seeking discharge, [the debtor] placed the rectitude of [her] prior dealings squarely in issue, for, as the Court has noted, the Act limits that opportunity to the 'honest but unfortunate debtor.'" *Brown v. Felsen*, 442 U.S. at 128 (quoting *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 54 S.Ct. 695, 699 (1934)).

Indeed, one can easily characterize dischargeability of the settlement debt as a "defense" by Mrs. Warner to enforcement of the settlement agreement, *not* a "claim" by the Archers against Mrs. Warner, such that nondischargeability issues simply cannot be considered within the scope of the general release of "all claims" against Mrs. Warner. "Rather, what [the creditor] is attempting to meet here is the new defense of bankruptcy which [the debtor] has interposed between [the creditor] and the sum determined to be due him." *Brown v. Felsen*, 442 U.S. at 133. Whether nondischargeability is appropriately characterized as a claim or a defense, though, given the express carveout in the release for the Warners' obligations under the settlement, it seems entirely legitimate to presume, in the absence of a specific agreement to the contrary, that the parties *did not* intend to foreclose any future efforts by the Archers to enforce the settlement agreement itself against Mrs. Warner, including by way of a nondischargeability determination.

Successor Liability and Bankruptcy Sales: Free and Clear of What?

The Third Circuit has rendered an extremely important decision regarding successor liability in *In re Trans World Airlines, Inc.*, 322 F.3d 283 (3d Cir. 2003), holding that a free-and-clear sale under Code § 363(f) can protect the purchaser from creditors' claims of successor liability. The significance of this decision comes from many sources. The modern so-called "reorganization" under Chapter 11 has, to a very large extent, evolved into a mechanism by which to expeditiously sell the business (or pieces of the business) of a financially distressed enterprise through § 363 sales. *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751 (2002). As discussed below, though, application of § 363(f) to a purchaser's successor liability exposure has proven particularly difficult, and the *TWA* decision, thus, will bring an added measure of predictability to bankruptcy sales in the Third Circuit. And, of course, the District of Delaware's residence in the Third Circuit simply amplifies the import of *TWA* through its inevitable impact on both (1) § 363 sales that have already been consummated through the Delaware bankruptcy court and (2) the attractiveness of the Delaware venue for future Chapter 11 filings.

The claims at issue in *TWA* arose out of various allegations of illegal employment discrimination, falling into two distinct categories. The first was a class action suit by flight attendants and the EEOC challenging a former maternity leave-of-absence policy at TWA under Title VII of the Civil Rights Act. This action settled in 1995 with TWA distributing travel vouchers to eligible class members (the "Travel Voucher Class"), and when TWA filed Chapter 11 (for the third time) in January 2002, many of these travel vouchers had not yet been redeemed. The second category of discrimination claims at issue were numerous claims that had been filed with the EEOC under various federal employment discrimination statutes, but that had not yet been resolved (the "Unliquidated Discrimination Claims"). In fact, the EEOC stated that they were "unable to estimate the value, if any, of these claims, or the likelihood that the EEOC would commence litigation on the basis of these claims." 322 F.3d at 286.

Even before its 2002 bankruptcy filing, TWA had determined that it was not viable as an independent airline and that its value could best be maximized if its business were acquired by another airline, and in that regard, had entered discussions with American Airlines regarding such an acquisition. Shortly before the TWA bankruptcy filing, American offered to purchase substantially all of TWA's assets, contingent upon a bankruptcy filing by TWA, a court-supervised auction of TWA's assets, and bankruptcy court approval of the sale. The ensuing Chapter 11 filing and bidding process did not produce any eligible competing offers, and thus, TWA's board of directors voted to accept the American offer to buy TWA's assets for $742 million.

The EEOC and the Travel Voucher Class objected to the sale to American as inconsistent with federal common law principles of successor liability to the extent that it purported to immunize American from any liability on the Unliquidated Discrimination Claims and the Travel Voucher Class's unredeemed travel vouchers. The bankruptcy court overruled these objections, holding that any such claim of successor liability against American was precluded by Code § 363(f), and both the District Court and the Third Circuit affirmed.

Sales Free and Clear and Successor Liability's Innate Immunity Therefrom

Code § 363(f) authorizes a trustee or debtor in possession to sell property of a bankruptcy estate "free and clear of any interest in such property of an entity other than the estate" under specified circumstances. This provision is derived from a general equitable power that inheres in the federal courts. Thus, the federal courts exercised free-and-clear sale powers in equitable receivership proceedings, without any express statutory authority such as that contained in Code § 363(f). *See Riverdale Cotton Mills v. Alabama & Georgia Manufacturing Co.*, 198 U.S. 188, 25 S.Ct. 629 (1905); *Julian v. Central Trust Co.*, 193 U.S. 93, 24 S.Ct. 399 (1904); *First National Bank v. Shedd*, 121 U.S. 74, 7 S.Ct. 807 (1887); *Mellen v. Moline Malleable Iron Works*, 131 U.S. 352, 9 S.Ct. 781 (1889). Likewise, federal bankruptcy statutes antedating the Bankruptcy Code contained no free-and-clear sale provision such as § 363(f). Nonetheless, federal bankruptcy courts have always effected free-and-clear sales through their inherent equitable powers. *See Van Huffel v. Harkelrode*, 284 U.S. 225, 52 S.Ct. 115 (1931) (1898 Act); *Ray v. Norseworthy*, 90 U.S. (23 Wall.) 128 (1874) (1867 Act); *Houston v. City Bank*, 47 U.S. (6 How.) 486 (1848) (1841 Act). The statutory sanction of this inherent equitable power in Code § 363(f) has been plagued by such intractable interpretational difficulties that it calls into question the wisdom of attempts (real or perceived) to comprehensively codify the contours of judicial processes. *See* July 2002 *Bankruptcy Law Letter*, at 7-10. Nowhere is this more evident than with respect to the effect of a free-and-clear bankruptcy sale upon a purchaser's potential successor liability—a liability theory unknown to the early common law that devised the free-and-clear judicial sale. [See Norton Bankr. L. & Prac. 2d §§ 37:20-37:22; Bankr. Serv., L Ed §§ 5:49, 5:50; Bankr. Desk Guide §§ 15:49, 15:50.]

In a 1987 law review article, Professor Carlson masterfully demonstrated the enigmatic character of successor liability. *See* David Gray Carlson, *Successor Liability in Bankruptcy: Some Unifying Themes of Intertemporal Creditor Priorities Created by Running Covenants, Products Liability, and Toxic-Waste Cleanup*, 50 LAW & CONTEMP. PROBS. No. 2, Spring 1987, at 119. The state-law system of priorities is dependent upon liens and foreclosure of those liens through free-and-clear sales. The distinguishing characteristic of successor liability (in all its various permutations), though, is that it defies foreclosure through sale at the instance of either the debtor or a lien claimant. Indeed, successor liability is essentially *created* through a sale of the debtor's property. Although not always in and of itself a sufficient condition, acquisition of the debtor's property, nonetheless, "is a necessary…element for a finding of successor liability." George W. Kuney, *Misinterpreting Bankruptcy Code § 363(f) and Undermining the Chapter 11 Plan Process*, 76 AM. BANKR. L.J. 235, 259 n.92 (2002). Yet, "successor liability does not *create* a new cause of action against the purchaser so much as it *transfers* the liability of the predecessor to the purchaser." *Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.)*, 184 B.R. 910, 920 (Bankr. W.D. Tex. 1995), *vacated after settlement*, 220 B.R. 909 (Bankr. W.D. Tex. 1998). "The whole purpose of a [successor liability] servitude is to guarantee that the new owner of property assumes his predecessor's personal liability, regardless of whether the new owner has consented to do so." Carlson, *supra*, 50 LAW & CONTEMP. PROBS. No. 2, at 136.

A creditor's ability to impose successor liability on a purchaser, in essence, gives that creditor a priority in the property sold. For example, if the creditor is owed $25 and the property sold is worth $100 in the absence of any successor liability, a purchaser that will be subjected to successor liability will either (1) pay only $75 for the property, discounting for her $25 post-sale liability to the creditor or (2) pay $100 for the property, but require escrow of $25 for direct payment to creditor as a condition to closing of the sale. Successor liability, though, is not technically a "lien" on the purchased property, because the creditor's recourse against the purchaser is not limited to the assets purchased. The successor assumes full personal responsibility for the predecessor's liability to the creditor, regardless of the value of the purchased property. This, of course, means that if the purchaser's successor liability exposure exceeds the value of the property itself (which is a distinct possibility in an era of mass tort product liability), the prospect of successor liability can serve to obstruct any sale that would give rise to successor liability—to the detriment of the very creditors whom successor liability is designed to protect, and to the detriment of society as a whole to the extent that assets are not transferred to their most productive uses.

So what to do with successor liability that would otherwise be triggered by a sale of property when that sale occurs in bankruptcy? Successor liability presents an inexorable collision between fundamental bankruptcy norms. Basic property of the estate principles derived from cases such as *Chicago Board of Trade v. Johnson*, 264 U.S. 1, 44 S.Ct. 232 (1924), indicate that the incidents of property of the estate are defined by nonbankruptcy law, which must be given effect in bankruptcy, including transfer restrictions that have the effect of awarding a de facto priority to certain creditors. Yet, at the same time, evolution of the free-and-clear sale power in the federal courts in general (and the federal bankruptcy courts in particular), as well as codification of the free-and-clear sale power in Code § 363(f), indicate that the effect of a bankruptcy sale is ultimately a question of federal bankruptcy law. The clash of these two notions is evident in the case law interpreting Code § 363(f) as applied to successor liability claims.

A § 363(f) Sale Free and Clear of "Any Interest in Such Property"

A Successor Liability Claim Is Not an "Interest in Property"

By its terms, Code § 363(f) authorizes a bankruptcy sale "free and clear of any *interest in* such *property*." (emphasis added). Because the basic nature of successor liability is an *in personam* obligation of the purchaser rather than an *in rem* encumbrance on the property sold, this supplies a basis on which to say that a successor liability claim is *not* an "interest in property" and is, thus, unaffected by § 363(f). *See, e.g., Zerand-Bernal Group, Inc. v. Cox*, 23 F.3d 159 (7th Cir. 1994) (in dictum); *In re Fairchild Aircraft Corp.*, 184 B.R. at 917-18; *Volvo White Truck Corp. v. Chambersburg Beverage, Inc. (In re White Motor Credit Corp.)*, 75 B.R. 944 (Bankr. N.D. Ohio 1987); *Rubinstein v. Alaska Pacific Consortium (In re New England Fish Co.)*, 19 B.R. 323 (Bankr. W.D. Wash. 1982). And, of course, the unarticulated assumption supporting such an interpretation is *Chicago Board of Trade*'s principle of pervasive deference to nonbankruptcy law to define parties' relative rights in bankruptcy proceedings:

> What the imposition of successor liability would accomplish, and what the district court objected to, would be a second opportunity for a creditor to recover on liabilities after coming away from the bankruptcy proceeding empty-handed. But a second chance is precisely the point of successor liability, and it is not clear why an intervening bankruptcy proceeding, in particular, should have a *per se* preclusive effect on the creditor's chances.

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

A Successor Liability Claim Is an "Interest in Property"

Other courts express consternation about successor liability's oblique reordering of priorities amongst creditors and, even more importantly, its inhibitive effects upon bankruptcy sales. Thus, the trend seems to be toward authorization of bankruptcy sales free and clear of successor liability claims, by various means. One approach is to say that § 363(f) is not the exclusive source of bankruptcy courts' power to authorize free-and-clear sales; the federal courts retain their implicit equitable free-and-clear sale powers, which are not limited by the terms of § 363(f). *See White Motor*, 75 B.R. at 948; *Forde v. Kee-Lox Manufacturing Co.*, 437 F. Supp. 631 (W.D.N.Y. 1977) (authorizing sale free and clear of successor liability claims under 1898 Act, pursuant to an implicit "power to sell the bankrupt's property, free of all *claims*, liens, or incumbrances" (emphasis added)); *cf.* July 2002 *Bankruptcy Law Letter*, at 10 (arguing that the Code's "overriding intent with respect to free-and-clear sales seems to be permissive rather than prohibitive"). Indeed, the Code itself seems to authorize sales free and clear of not only *in rem* interests in the property sold, but also creditors' *in personam* "claims."

Pursuant to Code § 1123(a)(5)(D) & (b)(4), a plan of reorganization can provide for sale of property of the estate, including a "sale of all or substantially all of the property of the estate," and Code § 1141(c) provides that "except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of *all claims and interests* of creditors." (emphasis added). This provision seems to more easily encompass sale free and clear of creditors' successor liability claims. *See White Motor*, 75 B.R. at 948-49; *Fairchild Aircraft*, 184 B.R. at 933. One could fashion an argument that the differential phrasing of § 363(f) (sale free and clear of "interests") and § 1141(c) (sale free and clear of "claims and interests") was purposeful, and Congress intended a more expansive sale power in the context of (and with all of the additional creditor protections attendant to) confirmed plans, as opposed to pre-plan § 363 sales. *See* Kuney, *supra*. But with the gradual demise of the doctrine of *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983), prohibiting pre-plan § 363 sales of substantially all of a debtor's assets as a *sub rosa* plan of reorganization, the courts have already implicitly rejected such distinctions between pre-plan and plan sales.

Consequently, most courts now construe successor liability claims to be an "interest in property" within the meaning of the free-and-clear sale provision of § 363(f). *See United Mine Workers of America 1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co.)*, 99 F.3d 573 (4th Cir. 1996); *In re Lady H Coal Co*, 193 B.R. 233 (Bankr. S.D. W.Va. 1996); *WBQ Partnership v. Virginia (In re WBQ Partnership)*, 189 B.R. 97 (Bankr. E.D. Va. 1995); *P.K.R. Convalescent Centers, Inc. v. Virginia (In re P.K.R. Convalescent Centers, Inc.)*, 189 B.R. 90 (Bankr. E.D. Va. 1995); *In re Creative Restaurant Management, Inc.*, 141 B.R. 173 (Bankr. W.D. Mo. 1992), *vacated as moot on other grounds*, 150 B.R. 232 (Bankr. W.D. Mo. 1992); *All American Living Systems v. Bonapfel (In re All American of Ashburn, Inc.)*, 56 B.R. 186 (Bankr. N.D. Ga. 1986). The Third Circuit in *TWA* adopted this broad interpretation of "interest in property" under § 363(f). "While the interests of the EEOC and the [Travel Voucher] class in the assets of TWA's bankruptcy estate are not interests in property in the sense that they are not *in rem* interests,…they are interests in property within the meaning of § 363(f) in the sense that they arise from the property being sold." *TWA*, 322 F.3d at 290. "In essence, [successor liability] runs with the property, so it is more than a mere claim against the debtor. [A successor liability claim] is an 'interest in property' insofar as it grants [a creditor] the right to proceed against the transferee." *WBQ Partnership*, 189 B.R. at 105.

Sale Free and Clear of Successor Liability "Claims"

By equating the scope of § 363(f) with § 1141(c), to encompass the "claims of creditors" that might otherwise run with the property and be assertable against a bankruptcy purchaser, "[t]he court's power to sell free and clear is…consistent with its power to discharge claims under a plan of reorganization." *White Motor*, 75 B.R. at 948; *see* Bankruptcy Code § 1141(d)(1)(A) (providing that "the confirmation of a plan discharges the debtor from any debt that arose before the date of such confirmation"); *id.* § 101(12) ("'debt' means liability on a claim"). Correlatively, an "asset sale approved by the bankruptcy court precludes suits against [the purchaser] for any claim that could have been brought against [the debtor's estate] during bankruptcy." *Ninth Avenue Remedial Group v. Allis-Chalmers Corp.*, 195 B.R. 716, 732-33 (N.D. Ind. 1996). Thus, creditors' only recourse on their pre-confirmation claims against the debtor is through the bankruptcy proceedings themselves. Discharge of all creditors' pre-confirmation claims prevents assertion of those claims against the post-confirmation reorganized debtor, and the free-and-clear sale power prevents assertion of those same claims against bankruptcy purchasers of the debtor's assets. Together, then, discharge and free-and-clear sales channel all creditors' pre-confirmation claims against the debtor into the bankruptcy court for payment only from the debtor's bankruptcy estate.

The Claimants' Rights Must Be Subject to a Money Satisfaction

The symmetry between the discharge power and the free-and-clear sale power is reinforced by Code § 363(f)(5), which authorizes sale "free and clear of any interest in property of an entity other than the estate, *only if*—such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest." (emphasis added). This is an important limitation on the free-and-clear sale power that prevents bankruptcy sales from extinguishing, for example, restrictive covenants respecting real property that "touch and concern" and, thus, "run with" the land. Because the beneficiaries of such restrictive covenants could insist upon compliance with such covenants via injunctive relief and could not be compelled to accept a big pile of money in lieu of their right to injunctive relief, a trustee or debtor-in-possession cannot sell property in bankruptcy free and clear of such restrictive covenants. *See, e.g., Gouveia v. Tazbir*, 37 F.3d 295 (7th Cir. 1994); *In re 523 East Fifth Street Housing Preservation Development Fund Corp.*, 79 B.R. 568 (Bankr. S.D.N.Y. 1987).

At first blush, Code §1141(c) does not seem to contain the same limitation as does § 363(f)(5), but it essentially incorporates this limitation, by definition, in its provision that any plan sale "is free and clear of all *claims*…of creditors." (emphasis added). A "claim" is defined in Code § 101(5) as either "(A) [a] right to payment" or "(B) [a] right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." By including within the scope of a "claim," subject to payment and discharge through bankruptcy proceedings, only those equitable remedies that give rise to a right to payment, Code § 101(5)(B) seems to be directed at precisely the same concept as § 363(f)(5). *See WBQ Partnership*, 189 B.R. at 106 (noting that "§ 365(f)(5) specifies a *money* satisfaction, which suggests that the interest must be reducible to a claim…define[d]…as a 'right to payment'—something than can be satisfied with money") Bankruptcy only deals with a debtor's monetary obligations—those which the debtor could satisfy through a monetary payment. If the debtor could not satisfy an obligation by tendering a big pile of money, the debtor's obligation will not be discharged in bankruptcy, and to the extent nonbankruptcy law would impose or transfer that same nonmonetary obligation to a purchaser of the debtor's property, a bankruptcy sale cannot relieve the purchaser of that obligation either.

With respect to the obligations at issue in *TWA*, the Third Circuit affirmed the bankruptcy court's conclusion that TWA's travel voucher obligations and its potential liability on the Unliquidated Discrimination Claims could be fully satisfied by monetary payments. In other cases, though, this limitation may blunt the impact of a free-and-clear sale on bankruptcy purchasers' potential successor liability. *See, e.g., Creative Restaurant*, 141 B.R. at 178 (bankruptcy purchaser took property free and clear of any successor liability to the NLRB for debtor's backpay and reinstatement obligations, which were reducible to money, but *not* free and clear of potential successor liability for debtor's obligations to conduct rerun election of collective bargaining representative, to expunge employee records, and to post notices concerning past violations, which were *not* reducible to money).

The Claimants Must Have Had a Meaningful Opportunity to Participate in the Bankruptcy Proceedings

Most of the cases that have held that a bankruptcy sale did not extinguish the purchaser's potential exposure to successor liability have involved product liability. For example, Debtor manufactured and sold Product pre-bankruptcy. Debtor sold its manufacturing business during the bankruptcy proceedings to Purchaser. Post-bankruptcy, Claimant is injured by Product. Debtor disposed of all assets in its bankruptcy proceedings and has dissolved, so Claimant sues Purchaser under a state-law successor liability theory. Purchaser asserts that Claimant's suit is barred by its free-and-clear bankruptcy purchase of Debtor's manufacturing business.

This scenario, of course, suggests all of the very difficult and unsettled issues surrounding so-called future claims and whether such claims are bankruptcy "claims" at all, subject to discharge in Debtor's bankruptcy proceedings—i.e., did Claimant's right to payment arise pre-bankruptcy, and if so, is discharge consistent with Due Process? *See* January 2001 *Bankruptcy Law Letter*, at 1-9. Of course, in our illustration, Debtor's dissolution after disposition of all assets provided Debtor a functional discharge even in the absence of a bankruptcy discharge. Equating the free-and-clear sale power with the power to discharge "claims," though, reveals that the successor liability issue raised by our illustrative scenario can be resolved only by consideration of the same host of future claims considerations implicated by discharge. If it is inappropriate for Debtor's bankruptcy proceedings to legally discharge Claimant's rights against Debtor, the same is true with respect to Claimant's successor liability remedy against Purchaser, which must also survive intact. And that is what explains most of the cases permitting successor product liability suits against a bankruptcy purchaser: (1) in the eyes of the court, the claimant did not have a bankruptcy "claim" and/or (2) expunging the claimant's successor liability rights against the purchaser by virtue of the bankruptcy sale would be inconsistent with the mandates of Due Process. *See, e.g., Zerand-Bernal Group v. Cox*, 23 F.3d at 163-64; *Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Industries, Inc.)*, 43 F.3d 714, 720-23 (1st Cir. 1994); *Michigan Employment Security Commission v. Wolverine Radio Co. (In re Wolverine Radio Co.)*, 930 F.2d 1132, 1145-47 (6th Cir. 1991); *Mooney Aircraft Corp. v. Foster (In re Mooney Aircraft, Inc.)*, 730 F.2d 367, 372-75 (5th Cir. 1984); *Fairchild Aircraft*, 184 B.R. at 919-34; *Schwinn Cycling & Fitness, Inc. v. Benonis (In re Schwinn Bicycle Co.)*, 210 B.R. 747 (Bankr. N.D. Ill.), *aff'd*, 217 B.R. 790 (N.D. Ill. 1997).

Determining the Priority of a Successor Liability Claim

Courts holding that creditors' successor liability rights are an "interest in property" subject to Code § 363(f) do so on the assumption that the creditors' claims must be relegated to the priority status of the general unsecured. Indeed, one of the driving motivations of these courts is to deny creditors the roundabout priority that successor liability would afford them. Thus, in addressing the employment discrimination claims of the EEOC and the Travel Voucher Class, the *TWA* court stated:

> [I]n the context of bankruptcy, these claims are, by their nature, general unsecured claims and, as such, are accorded low priority. To allow the claimants to assert successor liability claims against American while limiting other creditors' recourse to the proceeds of the asset sale would be inconsistent with the Bankruptcy Code's priority scheme.

322 F.3d at 292; *accord White Motor*, 75 B.R. at 949-51 (successor liability is preempted by Bankruptcy Code priorities); *New England Fish Co.*, 19 B.R. at 326-29 (same).

The priority scheme of the Bankruptcy Code, though, largely defers to relative priorities established by nonbankruptcy law, and as discussed above, the nonbankruptcy law of successor liability affords successor liability claimants a *de facto* priority. Thus, although successor liability claimants do not have a conventional *in rem* lien on their debtor's property, the holding that they nonetheless have an "interest in property" subject to § 363(f) suggests that they *do* have a "lien" within the meaning of the Bankruptcy Code. Code § 101(37) defines a "lien" as an "*interest in property* to secure payment of a debt." (emphasis added). Of course, if successor liability claimants have an "interest in property," its entire function and purpose is obviously to secure payment of the debtor's "debt" to them, apparently affording them a "secured claim" in bankruptcy under Code § 506(a), entitled to adequate protection in the context of any bankruptcy sale under Code § 363(e). *Cf. Chicago Board of Trade*, 264 U.S. at 15 (characterizing a transfer restriction that afforded certain creditors a *de facto* priority as in the nature of a "lien"). It is not at all far-fetched, then, to posit (as some courts do) that creditors' nonbankruptcy successor liability rights should be fully respected and preserved in federal bankruptcy proceedings.

Whether a "lien" priority is ultimately preserved in bankruptcy, though, must be determined through application of the strong-arm powers of Code § 544(a), the bankruptcy construct by which we gauge creditors' relative nonbankruptcy priority rights. The strong-arm powers confer upon the trustee or debtor-in-possession, as of the petition date and for the benefit of general unsecured creditors, a general judicial lien on all of the debtor's property. Thus, if a creditor has a nonbankruptcy priority right in the debtor's property that would prevail over the trustee/DIP's hypothetical judicial lien, then that creditor's priority right will survive intact in bankruptcy. If, however, the trustee/DIP's hypothetical judicial lien would defeat the creditor's interest, the trustee can avoid the creditor's interest, thus relegating the creditor to the residual priority status of the general unsecured.

The strong-arm powers are part-and-parcel of the Code's scheme by which it attempts to freeze creditors' relative priority rights as of the date of the filing of the bankruptcy petition. The unique nature of the successor liability "priority," though, seems to defy categorization under the Code's conventional mechanisms for ordering "lien" priorities. As Professor Carlson has demonstrated, the anomalous nature of successor liability makes the outcome of a priority dispute with a judicial lien creditor hopelessly indeterminate. *See* Carlson, *supra*, 50 Law & Contemp. Probs. No. 2, at 136-38, 143 n.110. Thus, return to our hypothetical of a successor liability claimant owed $25, versus a bankruptcy trustee's hypothetical general judicial lien on property worth $100 (hypothetically securing a claim of $100). Outside bankruptcy, the trustee's inability to foreclose the successor liability claim through an execution sale would mean that the most a purchaser subject to successor liability would pay for the property at an execution sale would be $75. Thus, the successor liability claim would essentially achieve priority over the trustee's judicial lien when the trustee attempts to enforce its judicial lien. However, if the successor liability claimant were to attempt to enforce its claim against the debtor, by proceeding to judgment and execution on its $25 claim, it would find that its resulting execution lien on the property would be subordinate to the prior execution lien of the trustee. The nonbankruptcy "priority" of a successor liability claimant, then, is not universal and is only achieved by *not* enforcing its claim against the debtor. Nothing in the Bankruptcy Code's strong-arm provision tells us in whose execution sale (the trustee's or the successor liability claimant's) we should judge relative priorities amongst competing claimants. "Accordingly, it is quite impossible to figure out whether [successor liability claimants] are more like secured or unsecured creditors." Carlson, *supra*, 50 LAW & CONTEMP. PROBS. No. 2, at 143 n.110.

The utter indeterminacy of the "priority" of successor liability claims outside bankruptcy helps explain why the courts have vacillated regarding the proper approach to successor liability in bankruptcy. This indeterminacy also seems to support the courts' tendency to *not* simply defer to nonbankruptcy law regarding the effect of bankruptcy sales on successor liability. The nonbankruptcy successor liability remedy is uniquely a creature of a *nonbankruptcy* dissolution of a business enterprise:

> Almost all of the reported decisions applying the bases of successor liability…involve predecessors that transfer all of their assets to successors and then dissolve or otherwise cease operations. Indeed, the predecessor's termination is the circumstance that, as a practical matter, most often gives rise to the need for a post-transfer tort plaintiff to look to the successor for recovery.

RESTATEMENT (THIRD) OF TORTS § 12 cmt. h, at 214 (1998). When the predecessor transfers all assets, ceases operations, and dissolves *in bankruptcy*, though, it is perfectly legitimate to say that, to the extent federal bankruptcy law provides claimants equitable recourse against the predecessor's bankruptcy estate, federal bankruptcy law must also be taken to have fully preempted claimants' nonbankruptcy successor liability remedies.

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EXAMINING EXCULPATION'S ETHICS: RETHINKING THE ETHICAL DUTIES OF A DEBTOR'S ATTORNEY IN REORGANIZATION

*By Bruce A. Markell**

I. INTRODUCTION

Chapter 11 reorganizations often are long, drawn-out and messy. Good attorneys use this chaos to their client's advantage by strategically assembling coalitions of stakeholders aligned with their client's interests, and by isolating those opposed.

Chapter 11 cases also often proceed with speed. Time erodes value, and devil take the hindmost (or allocates to the laggers nothing or next to nothing). The extraordinary reorganization powers contained in chapter 11 leaven this mix, allowing the deft and adroit to forge a viable reorganized debtor.

This process often foments disgruntlement. Time and reflection can turn promising deals into ugly ones, and clients often blame their lawyers for the fallout. Often this is unjustified.

But sometimes it is not. Lawyers make mistakes. And in the reorganization cauldron, where speed, power and scarcity intermix, small mistakes can have outsized consequences.

Reorganization is not unique in this respect. The sad fact is mistakes by lawyers are not unusual. In the world outside of reorganization, the tort of legal malpractice provides rough compensation for victims of malpractice. But, as my mother used to say, an ounce of prevention is worth a pound of cure. Every state promulgates and curates rules of conduct for lawyers designed in part to lessen the incidence of harmful mistakes. Often referred to as rules of professional responsibility, these rules tell lawyers how they must act to retain the privilege of representing (and charging) clients.

*The issues discussed in this article were inspired by the author's consultations with Ogborn Mihm LLP in relation to SC SJ Holdings LLC, Case No. 21-10549 (Bankr. D. Del.). Neither Ogborn Mihm or any other entity related to SC SJ Holdings, requested, reviewed or approved this article, or provided compensation or reimbursement for its writing or publication.

IN THIS ISSUE:

For this issue of the *Bankruptcy Law Letter*, I want to look at the rules related to a lawyer's conduct when lawyers seek to erase the mistakes they make in reorganization. In reorganization circles, this practice is often referred to as "exculpation."

Not to put too fine a point on it, but my basic point is that the process and effect of exculpation as reported in the cases is contrary to established rules of professional conduct. And most courts are letting lawyers get away with it.

I realize that these are bold and inflammatory statements. But by the end of this article, I hope to show their truth, and to suggest how the problem might be avoided.

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II. EXCULPATION

Exculpation arises in the context of a confirmed chapter 11 plan. The plan proponent will place language in the plan which exculpates—excuses—a certain class of entities from liability for their actions with respect to the debtor. If the court confirms the plan, the order confirming the plan will incorporate the exculpatory language, making it binding upon anyone who is bound by the order confirming the plan. Further, the plan will also typically contain language enjoining the commencement of any action covered by the exculpation clause.[1]

A. THE NATURE OF EXCULPATION

Much confusion arises over exactly what exculpation is. Start first, however, with what it is *not*: a release of claims *against* the debtor. Rather it is the converse: the *debtor's* release of claims it (or the estate) has against third parties.[2] As a result, exculpation does not interfere or implicate with the statutory discharge granted by Section 524.

As exculpation is not a discharge or release of claims against a debtor, it is also not a third-party release, which has been the subject of notoriety of late.[3] Rather, exculpation is an agreement by the estate, backed by a court order, giving up claims the debtor or the estate has against a class of entities. In short, the estate, for reasons explored below, is abandoning or settling a contingent asset—claims held against the exculpated entities. As a consequence, exculpation affects monetary rights the debtor's estate may have against the exculpated entities.

Some courts, however, view this differently. They state that exculpatory provisions do not release or relinquish property of the estate.[4] Rather these courts state these clauses "establish the standard of care that will trigger liability in future litigation by a non-releasing party against an exculpated party for acts arising out of a debtor's restructuring."[5] As no claims are affirmatively released or settled, there is no transfer of estate property.

Such an argument, however, is pure casuistry. Changing the standard of liability excludes some actions from recompense; it changes what was compensable into something noncompensable. That is a loss of a right for those actions. Stripped of legalize, exculpation clauses eliminate negligence claims against attorneys. As malpractice is grounded in negligence, malpractice claims are thus prohibited.[6] In any sane world, that is a loss of a chose in action, an intangible item of property.[7]

B. PREVALENCE

Who are the entities benefitting from exculpation? Not surprisingly, the class of entities exculpated in any plan is varied and may differ from case to case. In most cases, however, the estate agrees not to seek recourse against its professionals—its investment bankers, its accountants and, the focus of this article, its attorneys.

While there is a temporal aspect to exculpations in practice—many only relate to claims arising during the pendency of the debtor's case—that limitation is not universal. Many cases have permitted, for example, exculpations that extend to prepetition activities.[8]

And although early cases categorized exculpations as fit only for extraordinary cases, the extraordinary has become ordinary. As the Ninth Circuit recently noted, exculpatory clauses are "a commonplace provision in Chapter 11 plans."[9]

C. ATTORNEYS AND EXCULPATION

Many instances of commercial exculpation are unexceptional. Much like a plumber discounting her bill because her installation was not quite up to snuff, investment bankers might take less than their bill if they make a mistake or are found not to be credible.[10] In both cases, the service providers expect that to be the end of the matter. The dispute is compromised and settled. In a sense, that type of give-and-take is typical of all reorganizations.

But lawyers are not plumbers or even investment bankers. Lawyers are subject to codes of professional conduct. And these codes have bite: unlike aspirational codes of good behavior,[11] violation of attorney codes of professional responsibility can lead to the loss of one's license to practice.

III. ATTORNEY EXCULPATION OUTSIDE OF BANKRUPTCY

Given the disparity in knowledge and experience between lawyers and most of their clients, it is not surprising that these codes of professional conduct speak to the limitation and settlement of disputes over the quality of a lawyer's services. The main repositories of these principles are Rule 1.8(h) of the American Bar Association's Model Rules of Professional Responsibility,[12] and Section 54 of the American Law Institute's *Restatement (Third) of the Law Governing Lawyers*.[13] The ABA's Model Rules have been adopted (with relatively minor changes) by most state regulatory bodies as applicable to attorneys within that state.[14]

A. ABA RULE 1.8(h)

The Model Rules cover a lawyer's ability to regulate her relationship with her client. This regulation covers not only any contractual attempt to limit liability for future actions, but also attempts to compromise and settle claims against the lawyer for past actions.

The operative rule is Rule 1.8 of the Model Rules. It states:

> (h) A lawyer shall not:
> (1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or
> (2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.[15]

Rule 1.8(h)(1) is fairly simple. A lawyer cannot limit his liability to a client at the initiation of a representation unless the client is independently represented. This includes capping liability for malpractice to fees earned or paid, liquidated damages clauses, and the like.[16]

It does, however, permit contractual selection of the means to determine such liability. Arbitration clauses in retainer agreements are be permitted.[17] The rule also permits the limitation of the scope of services provides through so-called "bundling" arrangements,[18] as well as a firm's efforts to protect itself from the errors of individual attorneys through the use of limited liability entities, so long as various disclosure rules are met.[19]

Rule 1.8(h)(2) is somewhat more complex. It imposes requirements on the lawyer in order to resolve or settle "claim[s] or potential claim[s]" for malpractice the client may have against the lawyer. There are basically two such requirements: the lawyer must advise, in writing, of the "desirability" of seeking separate and independent counsel regarding such settlement and must give the client "a reasonable opportunity" to obtain such advice.

Rule 1.8(h)(2) exists to protect clients "in view of the danger that a lawyer will take unfair advantage of an unrepresented client or former client."[20]

B. ALI'S RESTATEMENT THIRD OF THE LAW GOVERNING LAWYERS

In 2000, the American Law Institute completed its third restatement of the *Law Governing Lawyers*. Written against the background of the ABA Model Rules, it contains greater burdens for lawyers who wish to contractually limit or reduce client claims.

Section 54 of the *Restatement* provides, in relevant part:

> (2) An agreement prospectively limiting a lawyer's liability to a client for malpractice is unenforceable.
>
> (3) The client or former client may rescind an agreement settling a claim by the client or former client against the person's lawyer if:
> (a) the client or former client was subjected to improper pressure by the lawyer in reaching the settlement; or
> (b) (i) the client or former client was not independently represented in negotiating the settlement, and (ii) the settlement was not fair and reasonable to the client or former client.
>
> (4) For purposes of professional discipline, a lawyer may not:
> (a) make an agreement prospectively limiting the lawyer's liability to a client for malpractice; or
> (b) settle a claim for such liability with an unrepresented client or former client without first advising that person in writing that independent representation is appropriate in connection therewith.

In addition to restating the basic requirements of Rule 1.8(h), section 54(4) of the *Restatement* adds substantive law consequences to failure to comply with the rules on settlement.[21] It grants to the client the ability to avoid a settlement in two circumstances: (1) if the client was unrepresented and the resulting settlement was not "fair and reasonable" to the client;[22] or (2) if the lawyer "subjected [the client] to improper pressure" in obtaining the settlement.[23]

What is a claim under the *Restatement*? Does it include any request to reduce fees? No. Comment *c* makes it clear that while "a claim includes requests for damages, fee forfeiture . . . or the like," it does not include "disputes as to disposition of documents or the amount of a lawyer's fee."[24]

C. KEY POINTS

From the above, it is an easy conclusion that the typical exculpation clause as reported in the cases qualifies as an attempt to settle any claim for malpractice. It seeks to preclude a client—the revested debtor—from bringing any action based on the professional's work rendered to the debtor or the estate. While there might be some exclusions—some exculpations exclude malpractice, others exclude willful misconduct or gross negligence[25]—the basic negligence action based on failure to adhere to duties owed to the debtor are terminated. Moreover, the typical plan will also combine exculpation with a plan injunction against even bringing an action based on the claims exculpated by the plan.

As such, were the exculpation provision presented to the client outside of bankruptcy, it is beyond cavil that attorneys would have to meet the requirements of the applicable version of Rule 1.8(h). Although the issue has been occasionally raised, usually by the Office of the United States Trustee,[26] there appear to be zero cases which apply the rule to confirmation of a chapter 11 plan. That is, no case has required separate counsel to advise the debtor. No case has required explicit written disclosure of that potential malpractice claims are being extinguished. No case has questioned why law firms do not discount their fees in return for exculpation (or question whether the debtor was informed of the intended inclusion of any exculpation clause when the law firm was initially retained).

In part, this failure can be explained by the somewhat mongrel basis for exculpation clauses in the first instance. Courts grapple with whether a plan may include such clauses, and that effort seems to overshadow the ethical nuances of their inclusion once authorized. The effort to legitimize exculpation clauses follows.

IV. PLANS AND EXCULPATION

The initial question is whether the Bankruptcy Code even authorizes exculpation clauses. Most courts have found that it does, albeit with some grumbling. The progress of provisions once deemed to be extraordinary to the commonplace has been described as "an example of the Lake Wobegon effect whereby many ordinary and average things are postured as extraordinary, causing the very concept of extraordinariness to lose meaning."[27]

A. THE JUSTIFICATIONS

Courts have used many bases to justify exculpation clauses. Cases from Delaware and the Third Circuit analogized such clauses to rights trustees and others have under common law;[28] such fiduciaries enjoy certain immunities and indemnification rights at common law. These courts thus viewed the exculpation clauses as somewhat redundant, sort of a match on a burning blaze.

The problem with this justification is that it can only reach fiduciaries such as the debtor, its lawyers and creditors' committees. It will not extend to other professionals, such as investment bankers and other financiers who undoubtedly contribute to the success of a confirmed plan. So other grounds have been explored.

In this search, courts have often relied on two "catch all" provisions to justify exculpation. As one might expect, Section 105(a), with its language giving the court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title,"[29] has been a prime candidate for justification.[30] So too has Section 1123(b)(6), which permits a plan to include "any other appropriate provision not inconsistent with the applicable provisions of this title."[31] Although sweeping, invocation of these provisions requires answering other questions—what are the specific provisions that Section 105 is being used to "carry out"? Why are exculpation clauses "appropriate" provisions in a plan?

A more satisfactory basis might be Section 1123(b)(3)(A), which permits plan provisions that "provide for—(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate."[32] After all, exculpation affects contingent claims the estate holds against those exculpated, and thus it, at a minimum, "adjusts" those claims.

At this point, however, uniformity of justification dissolves. Not all circuits employ the same standard for approving settlements and their concomitant releases in plans.[33] Some use the so-called "*Master Mortgage* factors, which require the court to examine (1) an identity of interest between the debtor and nondebtor such that a suit against the nondebtor will deplete the estate's resources; (2) a substantial contribution to the plan by the nondebtor; (3) the necessity of the release to the reorganization; (4) the overwhelming acceptance of the plan and release by creditors and interest holders; and (5) the payment of all or substantially all of the claims of the creditors and interest holders under the plan."[34] Others permit a debtor to release or exculpate claims in a plan if the provision is a valid exercise of the debtor's business judgment, is fair, reasonable, and in the best interests of the estate.[35] Still others adopt the general requirements of Bankruptcy Rule 9019.[36]

More recently, a district court has proposed a new test under which an exculpation clause "(a) . . . must be limited to the fiduciaries who have performed necessary and valuable duties in connection with the bankruptcy case; (b) is limited to acts and omissions taken in connection with the bankruptcy case; (c) does not purport to release any prepetition claims; (d) contains a carve out for gross negligence, actual fraud or willful misconduct; and, (e) contains a gatekeeper function."[37]

B. REASONABLENESS AND REWARD?

The lack of an agreed standard for approval of exculpation clauses is largely due to the lack of any statutory basis for such clauses combined with a lack of consensus as to their construction. Nonetheless, exculpation clauses are routinely approved, especially if confined to post petition activities (although there is some recent doubt there).[38]

The demand for such clauses is easy to understand. As stated by one court, "exculpation provisions are included so frequently in chapter 11 plans because stakeholders all too often blame others for failures to get the recoveries they desire; seek vengeance against other parties; or simply wish to second guess the decisionmakers in the chapter 11 case."[39]

As a result, court often point to the contributions to the reorganization effort made by those receiving the benefit of such clauses and intone that such effort would not have been made (or made with less vigor) if the promise of a lawsuit-free future were not made. They also point to the inclusion of such clauses as part of the grand bargains that usually produce confirmed plans, and the creditor approval of such plans as further justification for their approval.[40]

This may be acceptable for non-lawyers; this article makes no argument for or against exculpation of investment bankers and other non-lawyer professionals. Those professionals have their own codes of conduct for dealing with their clients, and that may be fodder for a future article.

But lawyers are different. They operate under defined rules that procedurally and substantively affect the settlement of any claim for misconduct in their representation. The pro forma extension of exculpation to lawyers presents issues in its very banality. Courts occasionally rail against this unthinking extension of exculpation and releases. As one court put it, "releases are not a merit badge that somebody gets in return for making a positive contribution to a restructuring. They are not a participation trophy, and they are not a gold star for doing a good job. Doing positive things in a restructuring case—even important positive things—is not enough."[41]

That sentiment echoes the purpose of Rule 1.8 and the *Restatement Third*. Application of these ethical and substantive authorities make deals between lawyers, even run-of-the mill settlements consistent with deals offered to non-lawyers, subject to procedural and substantive checks to ensure fairness and disincentivize overreaching.[42]

This has significant repercussions in reorganizations. If, for example, a lawyer enters into a restructuring engagement with a debtor expecting or requiring exculpation on confirmation, that raises issues regarding Rule 1.8(h)(1) and the ban on limiting liability for future acts. If the plan exculpates lawyers with written notice to their clients and an independent review of the legal effect of the exculpation clause, that raises issues under Rule 1.8(h)(2). Both acts raise issues as to whether the exculpation, if not independently reviewed, was "fair and equitable" under Section 54 of the *Restatement Third*.

But many would assert that any state regulation, including regulation of professional responsibility, is preempted by the federal nature of bankruptcy proceedings. That question takes up the next section.

V. ARE ETHICAL RULES PREEMPTED?

Courts categorize and conceptualize confirmed reorganization plans as contracts between the affected parties.[43] That categorization is appropriate for a plan's use of exculpation clauses; such clauses act as a part of a more general contract under which the debtor's estate releases any claim it may have against those exculpated. If the parties exculpated include the estate's and the debtor's lawyers, then the effect is as if the estate settled or abandoned all contingent claim it may have had against its lawyers, including claims for malpractice. On its face then, Rule 1.8 should apply.

But it hasn't.[44] One obvious argument against applying Rule 1.8 is that bankruptcy courts are federal courts, and that the Bankruptcy Code is federal law, and these two points require preemption of Rule 1.8 and the substantive law principles outlined in the *Restatement*. A deeper review of this argument shows its frailties.

A. PREEMPTION GENERALLY

The Supremacy Clause of the United States Constitution prohibits states from enacting laws that are contrary to the laws of our federal government: "This Constitution and the Laws of the United States . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."[45] It is through this clause that the United States Congress may preempt state law.

There are three ways in which a state law may be preempted. First, state law may be preempted where the United States Congress enacts a provision which expressly preempts the state enactment. Likewise, preemption may be found where Congress has legislated in a field so comprehensively that it has implicitly expressed an intention to occupy the given field to the exclusion of state law. In these two instances, Congress can be said to have preempted the field; that is, the field defined by the scope of the congressional action.

Even if the field regulated is not completely occupied by federal action, a state enactment will still be preempted when it conflicts with a federal law. This conflict is usually found in one of two situations: when it is impossible to comply with both federal and state law,[46] or when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[47]

The line between conflict and frustration has often been difficult to draw. As the Court recently stated in *Kansas v. Garcia*,[48] "[i]n all cases, the federal restrictions or rights that are said to conflict with state law must stem from either the Constitution itself or a valid statute enacted by Congress. 'There is no federal preemption in vacuo,' without a constitutional text, federal statute, or treaty made under the authority of the United States."[49]

Nevertheless, *Kansas v. Garcia* reiterated that it has long been established that preemption may also occur by virtue of restrictions or rights that are inferred from statutory law.[50]

B. NO FIELD PREEMPTION

In determining whether a state regulation is preempted by federal law, courts start "with the assumption that the historic police powers of the States [are] not to be superseded by . . . Federal Act unless it [is] the clear and manifest purpose of Congress."[51] In the area of professional responsibility, most courts have found that, even in areas of exclusive federal jurisdiction, the field of state regulation is not preempted.

Bankruptcy is not the only federal practice area. Specialized courts often have their own rules. For example, there are special rules for attorneys practicing in the patent and trademark area, in immigration courts, and in military tribunals.[52] Although case law is thin, no case has held that the establishment of specialized courts preempts all manner of state attorney regulation.

Bankruptcy practice presents an even easier case for dismissing field preemption. Although Congress did establish a separate bankruptcy court system, it did not provide any statutory guidance as to the lawyer regulation in those courts. Indeed, many (if not all) bankruptcy courts will adopt or incorporate state rules of professional responsibility into bankruptcy court practice.

C. NO CONFLICT PREEMPTION: INCORPORATION

When Congress has not preempted the field, conflict analysis is appropriate. But even before that analysis is undertaken, there is good reason to believe Rule 1.8 should apply in every reorganization. Why? Because most every bankruptcy court has, by its local rules, adopted the relevant state rules of professional responsibility as applicable to their court.

Delaware Local Bankruptcy Rule 1001-1(f),[53] for example, incorporates the District Court rules, and Rule 83.6(d) of those rules state:

> (d) Standards for Professional Conduct. Subject to such modifications as may be required or permitted by federal statute, court rule, or decision, all attorneys admitted or authorized to practice before this Court, including attorneys admitted on motion or otherwise, shall be governed by the Model Rules of Professional Conduct of the American Bar Association ("Model Rules"), as amended from time to time.[54]

No local rule exempts Rule 1.8.

The same appears to be true for the Southern

District of New York. The Second Circuit has indicated that New York's Rules of Professional Conduct "govern[] the conduct of attorneys in federal courts sitting in New York as well as in New York state courts."[55] The District Court explicitly refers to discipline for violation of these rules.[56]

As a result, no preemption analysis should be required. Bankruptcy courts should enforce Rule 1.8 as written, which would mean that they should require disclosure and separate representation for plans that contain attorney exculpation and should question or sanction attorneys who do not comply. It is simply a matter of enforcing their own rules.

Of course, adoption of the Model Rules only affects attorney discipline. No bankruptcy court seems to have adopted anything like Section 54 of the *Restatement*. To the extent that a court approves an exculpation clause propounded in violation of Rule 1.8, a knotty problem arises with respect to the validity of that clause. Outside of bankruptcy, Section 54 would require a finding that the clause is "fair and equitable" and that the debtor was separately represented; otherwise, the debtor could avoid the clause. If the bankruptcy court is acting pursuant to its powers to approve transfers under Section 1123(b)(3), there would seem to be power and ability to effectuate that transfer. As stated in the comments to Section 54, "[w]hatever the nature of the claim, once a settlement has been implemented in court through such means as entry of a judgment, it can be challenged only as permitted by applicable procedural rules."[57]

D. NO CONFLICT PREEMPTION: STATE INTEREST IN ATTORNEY REGULATION VS FEDERAL INTEREST IN FACILITATING REORGANIZATION

Even if bankruptcy courts had not bound themselves to follow the Model Rules, the issue would arise as to whether attorneys practicing in those courts would still be subject to Rule 1.8. The issue is one of conflict preemption; that is, whether there is a conflict with a federal statutory or regulatory scheme. Conflict, in turn, requires comparison; a conflict exists only to the extent that compliance with a state scheme impairs the ability of the federal scheme to achieve its purposes.

The comparison starts with traditional deference in preemption analysis to state exercise of police powers, especially with respect to regulation of the legal profession. When a court is presented with a matter that by long tradition has been left to state regulation, federal preemption will be found only if intervening events demonstrate that "that [is] the clear and manifest purpose of Congress."[58] As the Supreme Court has noted with respect to lawyer regulation:

> Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States and the District of Columbia within their respective jurisdictions. The States prescribe the qualifications for admission to practice and the standards of professional conduct. They also are responsible for the discipline of lawyers.[59]

This deference requires a strong and explicit federal interest before state regulation is preempted. And that is not the case with professional responsibility and bankruptcy. A lawyer's conduct rarely impacts the validity of any adjustments to the debtor-creditor relationship.[60] In short, how an attorney behaves rarely impacts the enforceability of liability adjusted by a plan of reorganization.

This distinction between how an attorney acts and the enforceability of her client's debts should apply with respect to Rule 1.8 and its application to reorganization attorneys. Exculpation, as explored above, has no specific authorization in the Bankruptcy Code. Indeed, many courts approve such clauses under "catch-all" provisions such as Sections 105(a) and 1123(b)(6). But even when justified under the settlement provisions of Section 1123(b)(3), the various standards for approving settlements indicate a role for state rules governing the lawyers' actions. This can be seen under either Rule 1.8(h)(1) regarding future liability, and Rule 1.8(h)(2) regarding settlement.

The federal interest in exculpation, if any, would seem to be in ensuring that debtors and other professionals paid by the estate have competent and experienced counsel. But the tradeoff between increased competency and loss of recourse is difficult to measure. It is not unlike removing warranty protection for a car or its parts—the manufacturer has done all it can, and it remains to be seen whether time can verify quality.

But the tradeoff can be taken too far; I doubt any court would approve a law firm's retention if they conditioned their representation on placing the debtor's president's mother in chains, and holding her in a basement, until all fees were paid. Indeed, there is a perverse reverse incentive here: since Rule 1.8(h)(1) otherwise prohibits limiting liability as a condition of retention, allowing an exception to that rule for bankruptcy would draw those who would rely on such a provision, thereby either reducing the incentive and consequences for competent practice, or increasing the risks the lawyer might be willing to take.

The same analysis applies to Rule 1.8(h)(2). The genesis of Rule 1.8(h)(2) lies in the asymmetry of knowledge and experience between lawyer and client. That imbalance is, if anything, greater in reorganization, given reorganization's—hopefully—once in a lifetime occurrence. As a result, the need for intelligent and well-informed decisions regarding releases of contingent assets is heightened.

A lawyer's ability to dispose of any existing claims of malpractice without compliance with Rule 1.8 presents another example of perverse incentives. It removes the risk of a subsequent dispute (especially if the exculpation clause is backed by plan injunctions), and deprives the reverted debtor (and, depending on the reorganization, its creditors) of a potential recovery without the examination Rule 1.8(h)(2) requires.

E. CONSEQUENCES

It should be stated that Rule 1.8 and the *Restatement* rules do not affect a bankruptcy court's power to confirm plans with exculpation clauses. The reason is simple: they cannot. States do not have the power granted Congress under the Bankruptcy Clause of the Constitution so long as title 11 is law. By the same token, however, by simply enacting the Bankruptcy Code, Congress has not preempted the states' ability to regulate attorneys practicing in bankruptcy law in bankruptcy tribunals. This lack of preemption should not be surprising as there is ample precedent for states to apply their rules of professional responsibility to local attorneys practicing in other federal tribunals.[61]

Indeed, in criminal prosecutions in federal court, Congress has reaffirmed the primacy and application of state regulation through the McDade Act,[62] which requires that "[a]n attorney for the Government shall be subject to State laws and rules, and local Federal court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in that State." Regulations under this statute state that it "should not be construed in any way to alter federal substantive, procedural, or evidentiary law."[63] This has caused the Justice Department to challenge state rules of professional responsibility for certain practices, albeit with limited success.[64] The general result, however, is that state ethics rules can be "enforced by the state defendants against federal prosecutors."[65]

Moreover, if there is perceived conflict between the state rules and federal practice, Congress or federal agencies can always attempt to specifically invoke preemption.[66] And this has occurred. The Army, for example, has noted that Rule 1.8 is inconsistent with congressional limitation on malpractice claims against Army attorneys, and has chosen not to adopt it with respect to Army attorneys practicing in military tribunals.[67]

Unlike practice before patent, immigration and military tribunals, there are no national rules regulating attorney conduct in bankruptcy court. Indeed, as shown above, most bankruptcy courts have simply adopted the rules of the state in which they sit. This relationship underscores the continued applicability of state rules of responsibility, and state rules regarding the law of lawyers, in bankruptcy court practice.

The recent Third Circuit case of *In re Boy Scouts of America*[68] is not contrary to this analysis. There, an insurance company contended that a law firm which represented it had violated Rule 1.7 regarding conflicts of interest when that law firm took on the representation of a debtor it insured.[69] Based on this contention—which the lower counts declined to determine[70]—the insurance company contended the law firm should be disqualified under Section 327 from representing the debtor.

The Third Circuit, speaking through Judge

Ambro, rejected the claim. Judge Ambro focused on Section 327 and its concern that lawyers should not have conflicts with the estate. That was a different focus from conflicts between creditors of the estate. On that point—conflicts with other creditors—Judge Ambro indicated Section 327 was indifferent, and so long as there were no disqualifying conflicts *with the estate*, Section 327 would not support disqualification.[71] And the lower courts had not decided that there was such a conflict.[72]

Judge Ambro did go on to indicate that Section 327 would not interfere with disputes between the debtor's counsel and the insurance company over the law firm's bankruptcy representation of the debtor, which apparently were subject to a pending arbitration.[73] That recognition impliedly assumed that there was no preemption. As a result, the opinion is consistent with the notion that bankruptcy does not preempt the field of regulating attorneys' conduct in bankruptcy proceedings and consistent with the point that state regulation of such conduct is only an issue when, as *Kansas v. Garcia* indicates, there is a federal text—regulation, statute or constitutional provision—which conflicts with the state regulation.

VI. CONCLUSION

Bankruptcy courts have been strangely silent on the applicability and effect of Rule 1.8 to exculpation clauses. This silence is odd given the relatively straightforward application of Rule 1.8's terms: lawyers cannot limit their liability prospectively and can't terminate their contingent liability for malpractice without giving their clients written notice of what's going on, and a realistic opportunity to obtain separate counsel to assess the fairness of the proposal. Although less clear, the failure to adhere to these rules, or to obtain specific findings compliant with non-bankruptcy law as restated in the *Restatement* runs the risk that such exculpation clauses will be avoided and for naught.

I acknowledge that compliance would be sticky and time-consuming. Two solutions, however, suggest themselves. The first is that plans could exempt malpractice from the scope of any proposed exculpation.[74] The second is that lawyers could try to justify exculpation by seeking findings that their value as reorganization lawyers exceeds the cost to the revested debtor of exculpation (that is, the benefit of any malpractice litigation).[75] Since the former essentially guts the value of exculpation to lawyers, and the latter requires a reduction of fees to reflect the benefit of being freed of malpractice risk, these solutions are not likely to be implemented any time soon.

ENDNOTES:

[1]This article only examines the interplay between exculpation clauses and professional responsibility rules. The effect of such rules on plan injunctions and upon claim and issue preclusion issues in final fee orders is not addressed and is reserved for future articles.

[2]In this article, I used "debtor" and "estate" interchangeably. Exculpation clauses seek to deprive the estate of claims the estate would have against third parties. These claims are typically claims arising during case administration, and thus are property of the estate under 11 U.S.C.A. § 541(a)(7). Some aggressive uses of exculpation additionally also seek to reach claims held by the debtor prepetition, and these claims would be property of the estate under 11 U.S.C.A. § 541(a)(1). As a result, at confirmation, the issue is over the fate of claims for relief or choses in action held by the estate. After confirmation, however, to the extent that such claims are not dealt with by the confirmed plan, they would usually revert to the reorganized debtor, and pursued by that entity. My analysis does not depend on when exculpation is challenged, and thus the interchangeability of the reference to the claim's owner.

[3]See, e.g., Lindsey Simon, Bankruptcy Grifters, 131 Yale L.J. 1154 (2022) (discussing abuse of nonconsensual nondebtor releases); Adam J. Levitin, Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances, 100 Tex. L. Rev. 1079, 1155 n.103 (2022).

Of course, the Bankruptcy Law Letter's fearless leader, Ralph Brubaker, has long decried the legitimacy of such releases, Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, 1997 U. Ill. L. Rev. 959, and recently renewed his objections in these pages, Ralph Brubaker, An Incipient Backlash Against Nondebtor Releases? (Part I): The "Necessary to Reorganization" Fallacy, Bankruptcy Law Letter (Feb. 2022). There is some recent indication of judicial backlash consistent with these critiques. See, e.g., Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (E.D. Va. 2022); In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021).

[4]See, e.g., In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021). Such statements seem to be contrary to the plain nature of such claims for relief. See note 1 supra.

[5]In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021); In re Health Diagnostic Laboratory, Inc., 551 B.R. 218, 232 (Bankr. E.D. Va. 2016) ("The practical effect of a proper exculpation provision is not to provide a release for any party, but to raise the standard of liability of fiduciaries for their conduct during the bankruptcy case.").

[6]"[L]egal malpractice is essentially an application of general tort law to particular contexts that happen to involve lawyers." Geoffrey C. Hazard, Jr., W. William Hodes & Peter R. Jarvis, The Law of Lawyering § 5.01 (4th ed. 2014).

[7]As stated by Justice Douglas, "[i]t has been commonly accepted in the federal courts that 'property' within the meaning of this [Bankruptcy Act § 77(a)] includes intangibles such as choses in action." Baker v. Gold Seal Liquors, Inc., 417 U.S. 467, 476, 94 S. Ct. 2504, 2510, 41 L. Ed. 2d 243 (1974).

[8]See. e.g., In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444 (Bankr. S.D. Ohio 2021).

[9]Blixseth v. Credit Suisse, 961 F.3d 1074, 1085, 68 Bankr. Ct. Dec. (CRR) 224 (9th Cir. 2020), cert. denied, 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021).

[10]See, e.g., In re Las Vegas Monorail Co., 462 B.R. 795, 804, 55 Bankr. Ct. Dec. (CRR) 231 (Bankr. D. Nev. 2011) (finding investment banker's testimony not credible).

[11]See, e.g., Morgan Stanley, Code of Conduct 2022, available at morganstanley.com/about-us-governance/code-of-conduct; Paul Clark, Bad behaviour is integral to an investment banking career—and this isn't changing, efinancialcareers (Nov. 29, 2013), available at https://www.efinancialcareers.com/news/2013/11/bad-behaviour-is-integral-to-an-investment-banking-career-and-this-isnt-changing.

[12]Model Rules of Pro. Conduct (Am. Bar Ass'n 2020), available at https://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/model_rules_of_professional_conduct_table_of_contents/. This article cites the rules contained in this code as "Rule X.X." The Model Rules replaced the earlier Model Code of Professional Responsibility and its Disciplinary Rules. Model Code of Pro. Resp. (Am. Bar Ass'n 1980).

[13]Restatement (Third) of the Law Governing Lawyers § 54 (2000). This article cites the sections contained in the Restatement as "Res3d § X."

[14]See George W. Kuney, Unethical Protection? Model Rule 1.8(H) and Plan Releases of Professional Liability, 83 Am. Bankr. L.J. 481, 484 n.4 (2009). Professor Kuney's article was one of the first to note the problems mentioned in this article but seems to have fallen on deaf ears since its publication. See also Kurt F. Gwynne, Indemnification and Exculpation of Professional Persons in Bankruptcy Cases, 10 Am. Bankr. Inst. L. Rev. 711, 725 (2002).

[15]Rule 1.8.

[16]See, e.g., Feacher v. Hanley, 2014 WL 119382 (D. Utah, Jan. 13, 2014) (lawyer contract with client cannot limit liability to amount of fees charged or include liquidated damages clause for particular breaches).

[17]Rule 1.8, cmt. 17 ("This paragraph does not, however, prohibit a lawyer from entering into an agreement with the client to arbitrate legal malpractice claims, provided such agreements are enforceable and the client is fully informed of the scope and effect of the agreement.").

[18]Rule 1.8, cmt. 17 ("Nor does it prohibit an agreement in accordance with Rule 1.2 that defines the scope of the representation, although a definition of scope that makes the obligations of representation illusory will amount to an attempt to limit liability.").

[19]Rule 1.8, cmt. 17 ("Nor does this paragraph limit the ability of lawyers to practice in the form of a limited-liability entity, where permitted by law, provided that each lawyer remains personally liable to the client for his or her own conduct and the firm complies with any conditions required by law, such as provisions requiring client notification or maintenance of adequate liability.").

[20]Rule 1.8, cmt. 18.

[21]The comment indicates that an agreement limiting liability prospectively is "against public policy because it tends to undermine competent and diligent legal representation. Also, many clients are unable to evaluate the desirability of such an agreement before a dispute has arisen or while they are represented by the lawyer seeking the agreement" Res3d § 54, cmt. b.

[22]Illustrative cases cited by the *Restatement* include Swift v. Choe, 242 A.D.2d 188, 674 N.Y.S.2d 17 (1st Dep't 1998) (release invalid when client had severe vision problem and lawyer failed to explain); Ames v. Putz, 495 S.W.2d 581 (Tex. Civ. App. Eastland 1973), writ refused, (Sept. 19, 1973) (release invalid when client not informed of its legal consequences and did not know of lawyer's malpractice);

[23]Improper pressure can include the "refusal to return documents or funds except upon release of the malpractice claim." Res3d § 54, cmt. c. This pressure exists "even if the client was independently represented, because representation does not necessarily dispel improper pressure." *Id.*

[24]Res3d § 54, cmt. c.

[25]See Sally McDonald Henry, Ordin on Contest-

ing Confirmation § 18.11 Exculpation Clauses (7th Edition 2022-1 Supplement). See also In re Reader's Digest Ass'n, No. 09-23529 (RDD), 2010 Bankr. LEXIS 5550, at *35-36 (Bankr. S.D.N.Y. Jan. 19, 2010); In re Extended Stay Inc., No. 09-13764, 2010 WL 6561113 (Bankr. S.D.N.Y. July 20, 2010).

[26]See, e.g., In re Stearns Holdings, LLC, 607 B.R. 781 (Bankr. S.D.N.Y. 2019); In re Winn-Dixie Stores, Inc., 356 B.R. 239 (Bankr. M.D. Fla. 2006).

[27]In re Astria Health, 623 B.R. 793, 801 n.25, 69 Bankr. Ct. Dec. (CRR) 195 (Bankr. E.D. Wash. 2021).

[28]See In re Washington Mutual, Inc., 442 B.R. 314, 350-51 (Bankr. D. Del. 2011) ("The exculpation clause must be limited to the fiduciaries who have served during the chapter 11 proceeding: estate professionals, the Committees and their members, and the Debtors' directors and officers.").

[29]11 U.S.C.A. § 105(a).

[30]In re Airadigm Communications, Inc., 519 F.3d 640, 657, 49 Bankr. Ct. Dec. (CRR) 179, Bankr. L. Rep. (CCH) P 81123 (7th Cir. 2008) (describing section 1123(b)(6) as working in tandem with section 105(a) to ensure "a bankruptcy court is also able to exercise [its] broad equitable powers within the plans of reorganization themselves").

[31]11 U.S.C.A. § 1123(b)(6). See, e.g., U.S. v. Energy Resources Co., Inc., 1990-2 C.B. 263, 495 U.S. 545, 549, 110 S. Ct. 2139, 109 L. Ed. 2d 580, 20 Bankr. Ct. Dec. (CRR) 840, 22 Collier Bankr. Cas. 2d (MB) 1093, Bankr. L. Rep. (CCH) P 73381, 90-1 U.S. Tax Cas. (CCH) P 50281, 65 A.F.T.R.2d 90-1078 (1990) (explaining that then section 1123(b)(5)—currently section 1123(b)(6)—provides "residual authority" for bankruptcy courts to approve plans containing features that are not explicitly authorized by statute "consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships"); In re Adelphia Communications Corp., 441 B.R. 6, 19, 53 Bankr. Ct. Dec. (CRR) 267 (Bankr. S.D. N.Y. 2010) ("Section 1123(b)(6), by its terms, is plainly a broad grant of authority. As previously noted, reorganization plans, after they get the requisite assent, may allocate and distribute the value of debtors' estates by a broad array of means.").

[32]11 U.S.C.A. § 1123(b)(3)(A).

[33]See 7 Collier on Bankruptcy ¶ 1123.02[3] (Henry Sommer & Richard Levin, eds., 16th ed. 2022) for a collection of cases.

[34]In re Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 937, 31 Collier Bankr. Cas. 2d (MB) 240 (Bankr. W.D. Mo. 1994). See, e.g., *In re rue21, inc.,* 575 B.R. 314, 324, 64 Bankr. Ct. Dec. (CRR) 168 (Bankr. W.D. Pa. 2017) (if the release is so intertwined within the plan terms that it is not easy to distinguish where the settlement ends and the plan begins, it should be evaluated under the Master Mortgage factors).

[35]In re Spansion, Inc., 426 B.R. 114, 143 (Bankr. D. Del. 2010) (section 1123(b)(3)(A) permits a debtor to release claims in a plan if the release is a valid exercise of the debtor's business judgment, is fair, reasonable, and in the best interests of the estate); In re DBSD North America, Inc., 419 B.R. 179, 217 (Bankr. S.D. N.Y. 2009), aff'd, 2010 WL 1223109 (S.D. N.Y. 2010), judgment aff'd in part, rev'd in part, 627 F.3d 496 (2d Cir. 2010), opinion issued, 634 F.3d 79, 65 Collier Bankr. Cas. 2d (MB) 201, Bankr. L. Rep. (CCH) P 81933 (2d Cir. 2011) (1123(b)(3) permits a debtor to include a settlement of any claims it might own as a discretionary provision in its plan); In re Hercules Offshore, Inc., 565 B.R. 732, 755-56 (Bankr. D. Del. 2016) (release of secured lender appropriate when lender agreed to concessions under a settlement that provided for the payment in full of all unsecured claims, consideration to equity holders and a reduction in estate liabilities).

[36]In re Astria Health, 623 B.R. 793, 800, 69 Bankr. Ct. Dec. (CRR) 195 (Bankr. E.D. Wash. 2021) ("In the Ninth Circuit, bankruptcy courts reviewing settlements are generally to consider (1) the probability of success in potential litigation; (2) the difficulties, if any, to be encountered in the matter of collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.").

[37]Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641, 702 (E.D. Va. 2022). See also In re Health Diagnostic Laboratory, Inc., 551 B.R. 218, 234 (Bankr. E.D. Va. 2016) (exculpation provision approved if it "(a) is narrowly tailored to meet the needs of the bankruptcy estate; (b) is limited to parties who have performed necessary and valuable duties in connection with the case (excluding estate professionals); (c) is limited to acts and omissions taken in connection with the bankruptcy case; (d) does not purport to release any pre-petition claims; and (e) contains a gatekeeper function by which the Court may, in its discretion, permit an action to go forward against the exculpated parties.").

[38]See, e.g., In re Murray Metallurgical Coal Holdings, LLC, 623 B.R. 444, 504 (Bankr. S.D. Ohio 2021) ("exculpation need not be limited to postpetition conduct.").

[39]In re Chemtura Corp., 439 B.R. 561, 610 (Bankr. S.D. N.Y. 2010).

[40]See, e.g., In re Winn-Dixie Stores, Inc., 356 B.R. 239, 257 (Bankr. M.D. Fla. 2006). Indeed, the acceptability of such justifications lead the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 to suggest changes to the

Bankruptcy Code to specifically authorize exculpation clauses in Chapter 11 plans. Am. Bankr. Inst. Comm'n to Study the Reform of Chapter 11, 2012—2014 Final Report and Recommendations, 23 Am. Bankr. Inst. L. Rev. 1, 271–79 (2015).

[41]In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726-27 (Bankr. S.D. N.Y. 2019).

[42]Comment c to Res3d § 54 lists several illustrative cases, such as Cohen v. Surrey, Karasik & Morse, 427 F.Supp. 363 (D.D.C. 1977) (upholding release by wealthy and sophisticated clients, one a lawyer, given in exchange for reduction in unpaid fee); Donnelly v. Ayer, 228 Cal. Rptr. 764 (Cal.Ct.App.1986) (upholding release given after client-lawyer relationship ended and client consulted malpractice lawyer); Ames v. Putz, 495 S.W.2d 581 (Tex. Civ. App.1973) (release invalid when client not informed of its legal consequences and did not know of lawyer's malpractice); Marshall v. Higginson, 813 P.2d 1275 (Wash. Ct. App.1991) (release set aside despite compliance with Rule 1.8(h), because lawyer obtained release by saying he would not testify for former client without it).

[43]See, e.g., Harper v. Oversight Comm. (In re Conco, Inc.), 855 F.3d 703, 711 (6th Cir. 2017) ("In interpreting a confirmed plan, courts use contract principles, since the plan is effectively a new contract between the debtor and its creditors. ... State law governs those interpretations." (quoting In re Dow Corning, Corp., 456 F.3d 668, 674-75 (6th Cir. 2006). See also 7 Collier on Bankruptcy ¶ 1129.01 (Henry Sommer & Richard Levin, eds., 16th ed., 2022).

[44]Courts have rebuffed efforts to apply Rule 1.8 to plan confirmations. See, e.g., In re Stearns Holdings, LLC, 607 B.R. 781, 791 (Bankr. S.D.N.Y. 2019) ("the Court declines to grant the UST's request that the Amended Plan be modified to include a caveat that the exculpation provision is consistent with Rule 1.8(h)(1), as such caveat is neither warranted nor required."); In re Fraser's Boiler Service, Inc., 593 B.R. 636, 641 (Bankr. W.D. Wash. 2018). This issue is not new. It was flagged over a decade ago by Professor George Kuney. George W. Kuney, Unethical Protection? Model Rule 1.8(H) and Plan Releases of Professional Liability, 83 Am. Bankr. L.J. 481 (2009).

[45]U.S. Const. art. VI, cl.2.

[46]Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963).

[47]Hines v. Davidowitz, 312 U.S. 52, 67, 61 S. Ct. 399, 85 L. Ed. 581 (1941).

[48]Kansas v. Garcia, 140 S. Ct. 791, 206 L. Ed. 2d 146 (2020).

[49]Kansas v. Garcia, 140 S. Ct. 791, 801, 206 L. Ed. 2d 146 (2020) (quoting Puerto Rico Dept. of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 503, 108 S. Ct. 1350, 99 L. Ed. 2d 582 (1988)).

[50]Kansas v. Garcia, 140 S. Ct. 791, 801, 206 L. Ed. 2d 146 (2020) (citing Osborn v. Bank of U.S., 22 U.S. 738, 865, 6 L. Ed. 204, 1824 WL 2682 (1824) (rejecting argument that a federal exemption from state regulation "not being expressed, ought not to be implied by the Court"), as well as Arizona v. U.S., 567 U.S. 387, 400-408, 132 S. Ct. 2492, 183 L. Ed. 2d 351, 115 Fair Empl. Prac. Cas. (BNA) 353, 95 Empl. Prac. Dec. (CCH) P 44539 (2012); Kurns v. Railroad Friction Products Corp., 565 U.S. 625, 630-631, 132 S. Ct. 1261, 182 L. Ed. 2d 116, 33 I.E.R. Cas. (BNA) 577, Prod. Liab. Rep. (CCH) P 18789, 78 A.L.R. Fed. 2d 677 (2012); PLIVA, Inc. v. Mensing, 564 U.S. 604, 617-618, 131 S. Ct. 2567, 180 L. Ed. 2d 580, Prod. Liab. Rep. (CCH) P 18642 (2011).

[51]Cipollone v. Liggett Group, Inc., 505 U.S. 504, 516, 112 S. Ct. 2608, 120 L. Ed. 2d 407, Prod. Liab. Rep. (CCH) P 13199, 17 U.C.C. Rep. Serv. 2d 1087 (1992) (citing Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947)). See also Office Of Disciplinary Counsel v. Marcone, 579 Pa. 1, 855 A.2d 654, 664 (2004).

[52]See, e.g., 35 U.S.C.A. § 2(b)(2)(D) (authorizing rules for practice before patent tribunals); 37 C.F.R. §§ 11.101-.901 (2013) (promulgated rules for practice before patent tribunals); 8 U.S.C.A. § 1103 (authorizing rules for practice in immigration tribunals); 8 C.F.R. § 1003.101-.111 (2017) (rules applicable to attorneys practicing in immigration courts); 32 C.F.R. § 776.18-.71 (2022) (rules of professional responsibility for military tribunals).

[53]Bankr. D. Del. R. 1001-1(f)(2021).

[54]D. Del. R. 83.6(d) (2016).

[55]See S.E.C. v. Gibraltar Global Securities, Inc., 2015 WL 2258173 at *2 (S.D. N.Y. 2015); see also In re Bruno, 327 B.R. 104, 108 (Bankr. E.D. N.Y. 2005) ("Bankruptcy courts in New York apply New York's Code of Professional Responsibility to ethical disputes.") (citing Kittay v. Kornstein, 230 F.3d 531, 537, 36 Bankr. Ct. Dec. (CRR) 259, 48 Fed. R. Serv. 3d 429 (2d Cir. 2000)).

[56]Local Civil Rule 1.5(5) of the Local Rules of the United States District Courts for the Southern and Eastern Districts of New York, state:

> Discipline or other relief . . . may be imposed, by the Committee on Grievances . . . if any of the following grounds is found by clear and convincing evidence: [¶] (5) In connection with activities in this Court, any attorney is found to have engaged in conduct violative of the New York State Rules of Professional Conduct as adopted from time to time by the Appellate Divisions of the State of New York.

[57]Res3d § 54, cmt. c.

[58]Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947). See also

Barnett Bank of Marion County, N.A. v. Nelson, 517 U.S. 25, 31, 116 S. Ct. 1103, 134 L. Ed. 2d 237 (1996) (noting that such intent may be expressed explicitly in the language of a statute, or implicitly through passage of a statutory scheme that extensively occupies the field, or where the purpose and objectives of federal law would be frustrated by state law).

[59]Leis v. Flynt, 439 U.S. 438, 442, 99 S.Ct. 698, 58 L.Ed.2d 717 (1979). See also Bradwell v. Illinois, 16 Wall. 130, 83 U.S. 130, 139, 21 L.Ed. 442 (1872) ("[U]nless we are wholly and radically mistaken . . ., the right to control and regulate the granting of license to practice law in the courts of a State is one of those powers which are not transferred for its protection to the Federal government . . . .") See also Castellanos-Bayouth v. Puerto Rico Bar Ass'n, 483 F. Supp. 2d 167, 175-76 (D.P.R. 2007)

[60]A comparison might be made to 29 U.S.C.A. § 959(b) and its requirement that a debtor in possession observe all non-bankruptcy laws. Of course, the section only applies to debtors in possession, and not their attorneys, but it would be odd to continue state law restrictions on debtors but suspend them for its counsel.

[61]In Attorney Grievance Comm'n of Maryland v. Tatung, 476 Md. 45, 258 A.3d 234 (2021), for example, a Maryland court applied the Maryland rules of professional responsibility to actions taken by a lawyer in Maryland with respect to an immigration proceeding before a federal tribunal in Texas. And, in Max-Planck-Gesellschaft ZUR Foerderung Der Wissenschaften E.V. v. Wolf Greenfield & Sacks, PC, 661 F. Supp. 2d 125, 128 (D. Mass. 2009), the court stated that "the authority of states to punish attorneys who violate ethical duties under state law" extended to actions of attorneys appearing before federal patent tribunals. Id. (quoting Kroll v. Finnerty, 242 F.3d 1359, 1364 (Fed. Cir. 2001). See also State ex rel. York v. West Virginia Office of Disciplinary Counsel, 231 W.Va. 183, 44 S.E.2d 293 (2013) (holding that federal law authorizing the United States Patent and Trademark Office to regulate the conduct of patent attorneys did not preempt state's attorney disciplinary proceeding against attorney).

[62]28 U.S.C.A. § 530B(a).

[63]28 C.F.R. § 77.1(b).

[64]Compare United States v. Colo. Supreme Court, 189 F.3d 1281, 1288-89 (10th Cir. 1999) (holding that Colorado's Rule of Professional Responsibility 3.8 regarding compelled lawyer testimony prescribed "broad normative principles of attorney self-conduct," and that "the rule in its current incarnation is a rule of ethics applicable to federal prosecutors by the McDade Act," and that that Rule 3.8 could be "enforced by the state defendants against federal prosecutors") with United States v. Supreme Court of New Mexico, 839 F.3d 888 (10th Cir. 2016) (finding *Colorado Supreme Court* was limited to application of Rule 3.8 to trial subpoenas, and holding it preempted as to grand jury subpoenas).

[65]United States v. Colo. Supreme Court, 189 F.3d 1281, 1288-89 (10th Cir. 1999).

[66]While it is doubtful that a single bankruptcy judge could invoke conflict preemption regarding exculpation in a single chapter 11 case, that doubt itself becomes doubtful were Congress or even the Bankruptcy Rules Committee to promulgate such a rule. No doubt that is why the American Bankruptcy Institute's Commission suggested Congress address the exculpation issue. Am. Bankr. Inst. Comm'n to Study the Reform of Chapter 11, 2012—2014 Final Report and Recommendations, 23 Am. Bankr. Inst. L. Rev. 1, 279 (2015).

[67]Although the Army has adopted most of the American Bar Association's Model Rules, it specifically has excluded Rule 1.8. See Comment 14 to Rule 1.8, Rules of Professional Conduct for Lawyers, Army Regulation 27–26, at 37 (June 2018) ("ABA Model Rule 1.8(h) is not adopted into Army Rule 1.8 because it is doubtful that Army lawyers would find it necessary to obtain prospective malpractice liability releases from clients such as the ones provided for in ABA Model Rule 1.8(h).").

[68]In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643 (3d Cir. May 24, 2022).

[69]In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *1-*3 (3d Cir. May 24, 2022).

[70]In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *2-*3 (3d Cir. May 24, 2022).

[71]"Save the "any other reason" catchall, the focus dead ends at the debtor and especially its estate." In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *4 (3d Cir. May 24, 2022). See also id. at *8 ("In holding that the Bankruptcy Court permissibly allowed BSA to retain Sidley as its restructuring counsel, our concern is primarily whether it could effectively represent BSA in its bankruptcy case.").

[72]"Century [the insurance company] has not meaningfully challenged the Bankruptcy Court's factual finding that Sidley [debtor's counsel] did not have an interest adverse to the estate." In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *5 (3d Cir. May 24, 2022).

[73]"In holding that the Bankruptcy Court permissibly allowed BSA to retain Sidley as its restructuring counsel, our concern is primarily whether it could effectively represent BSA in its bankruptcy case. Whether it did so in Century's reinsurance matters is a separate question that Century can independently challenge in its arbitration proceeding with Sidley." In re Boy Scouts of Am., No. 21-2035, 2022 WL 1634643, at *8 (3d Cir. May 24, 2022).

[74]Indeed, that is what some plans have provided.

See, e.g., In re Reader's Digest Ass'n, No. 09-23529 (RDD), 2010 Bankr. LEXIS 5550, at *35-36 (Bankr. S.D.N.Y. Jan. 19, 2010); In re Extended Stay Inc., No. 09–13764, 2010 WL 6561113 (Bankr. S.D.N.Y. July 20, 2010).

[75]Given the multiplicity of standards for approving exculpation explored above, it would not seem to add much to the mix to require lawyers comply with Rule 1.8 at the disclosure statement stage. This was the early suggestion of Professor Kuney. George W. Kuney, Unethical Protection? Model Rule 1.8(h) and Plan Releases of Professional Liability, 83 Am. Bankr. L.J. 481 (2009).

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	Chapter 11
	:	
MERCON COFFEE CORPORATION, et al.,[1]	:	Case No. 23-11945 (MEW)
	:	
Debtors.	:	Jointly Administered

DECISION REGARDING OBJECTIONS BY THE UNITED STATES TRUSTEE TO CONFIRMATION OF THE DEBTORS' FOURTH AMENDED PLAN OF REORGANIZATION

The Debtors in these jointly administered cases seek confirmation of their Fourth Amended Plan of Reorganization (the "Plan"). *See* ECF No. 514. There are no objections except for those posed by the Office of the United States Trustee (the "UST"). The UST contends:

(a) that the Plan permits the retention of equity interests even though some senior creditor classes are not being paid in full and have not accepted the Plan; and

(b) that the Plan proposed to grant releases to certain parties without adequate consideration.

During a confirmation hearing on June 28, 2024, the Debtors stated that releases had been promised several months ago in response to threats by a number of officers and directors to terminate their employment and as inducements to continue their employment. I invited the parties to file additional submissions regarding the potential application of section 503(c) in light of these statements, and the parties have done so. *See* ECF Nos. 660, 664, 666.

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[1] The debtors and debtors in possession in these cases and the last four digits of their respective Employer Identification Numbers are: Mercon Coffee Corporation (1844); Mercon B.V. (N/A); Mercon Brasil Comércio de Café Ltda. (N/A); Agro International Holding B.V. (N/A); Mercapital de Nicaragua, S.A. (N/A); Distribuidora de Granos de Nicaragua S.A. (N/A); Cisa Export S.A. (N/A); Comercial Internacional de Granos de Honduras, S.A. de C.V. (N/A); Mercon Guatemala, S.A. (N/A); Comercial Internacional Exportadora, S.A. (N/A). The Debtors' mailing address is: 999 Ponce de Leon Blvd, Suite 910, Coral Gables, FL 33134.

Cancellation of Equity Interests

Debtor Mercon B.V. is a Dutch private company and is the ultimate parent company of the Debtors. Mercon B.V. has assets in The Netherlands and other European Union countries. The Netherlands has not adopted the UNCITRAL Model Law on Cross-Border Insolvency. In order to protect its assets, and to facilitate the liquidation that is being accomplished in this Court, Mercon B.V. commenced a proceeding in The Netherlands. The Plan in this Court describes how Mercon B.V.'s creditors are to be treated, and provides that the equity interests in Mercon B.V. will be cancelled and will receive no distributions. However, in accordance with Dutch law the formal cancellation of the equity interests will not occur until such time as Mercon B.V. is formally dissolved under Dutch law.

Not all classes of creditors voted to accept the Plan, so confirmation can only be granted in this Court pursuant to the cram-down provisions of section 1129(b). The UST argued at the confirmation hearing that the delayed cancellation of equity interests in Mercon B.V. amounts to a "retention" of interests by equity owners that is prohibited under section 1129(b) because creditors are not being paid in full and because not all creditor classes accepted the Plan.

I disagree with the contention that the equity owners of Mercon B.V. will "retain" any property under the Plan. The Plan provides for the cancellation of equity interests. In addition, the Plan provides that the Debtors will be liquidated; that the liquidation will be accomplished by court-appointed trustees; that the equity interest holders will have no continuing control over any part of that process; and that the equity interest holders will not be entitled to any distributions. The equity interest holders will receive nothing that should or could have been distributed instead to creditors. Any "interests" that the equity owners may nominally hold (until the former cancellation occurs) have been stripped of all rights and meaning; they will be "equity interests" in name only but not in substance. Under the circumstances, the minor delay in the cancellation of the equity interests is not a "retention" of equity rights or property that runs afoul of section 1129(b).

The Proposed Releases

Section 12.03 of the Plan provides for the release of the Debtors' claims against various parties, subject to certain exclusions. The proposed release applies to all claims of any kind except that (a) if any Released Party is an insured person under a D&O policy, the release is limited to "the liability of any such party or person that exceeds the proceeds of the D&O Policies," and (b) no release is granted for any act or omission that constitutes fraud, gross negligence or willful misconduct as determined by a court of competent jurisdiction. The "Released Parties" originally were to include all of "the current and former directors, officers, representatives, members of management and other employees of the Debtors" but would not have included any accountants or current or former equity holders. In a memorandum filed on June 25, 2024, however, the Debtors proposed to modify the relevant Plan provisions so as to substitute the phrase "Released Mercon D&Os" in place of the general reference to all past and present directors, officers, etc. ECF No. 638. The term "Released Mercon D&O's" includes 19 individuals who were listed in an Exhibit to the memorandum. *Id*. at Ex. A.

The explanations for the proposed releases have been somewhat difficult to pin down. When the releases were first proposed, the UST objected to the proposed Disclosure Statement on the ground that it failed to explain why the releases were being granted and what consideration the Debtors were receiving in return. ECF No. 425 at 24–26. At that time the proposed Disclosure Statement included only the following language:

> The Debtors believe that the Released Parties . . . have made substantial and valuable contributions before and during the Debtors' Chapter 11 Cases

> through efforts to negotiate and implement the Plan, which maximizes the value of the Debtors for the benefit of all parties in interest, and to pay down the amounts due under the Prepetition First Lien Credit Agreement. Accordingly, it is the Debtors' position that each of the Released Parties . . . warrants the benefit of the release . . . provisions.

ECF No. 378 at 7. At a hearing on May 14 the Debtors contended that issues regarding the propriety of the releases should be resolved at the confirmation hearing and that the Debtors did not need to offer further explanations and justifications in the Disclosure Statement. ECF No. 494, Tr., 5/14/2023 at 14:2215:5. I said, though, that the Plan had incorporated a proposed release that would be subject to the requirements of Rule 9019 and that the Disclosure Statement was the only place where creditors could find information about that proposal so that they could decide whether to object to it. Accordingly, "your explanation of why you are proposing the grant such broad releases, and how they work, and what would be excluded really belongs in the disclosure statement." *Id*. at 15:1216. I also stated that the Debtors should disclose "whether you have investigated potential claims or not and what you've concluded about them . . ." *Id*. at 15:24-16:1. I added:

> You don't get a release just because you worked and continued to get paid after the petition date. That's not going to be enough. You're going to have to explain that you've taken a look at it, that these are reasonable in your view, and give creditors some reason to understand why you want to do it, and what you think the effect would be, and whether the effect would be to release any claims that might have any merit. And if that's what you want to do, that's what you're going to have to say.

Id. at 16:3-11; *see also id.* at 22:2-16.

The Debtors made revisions to the Disclosure Statement following the hearing, and before the confirmation hearing the Debtors made many further submissions regarding the proposed releases, including three separate declarations by Harve Light, the Debtors' chief restructuring officer. The Debtors argued:

- The proposed release are not "full" releases because (a) if insurance is available, the proposed releases would apply only to the extent that a claim would exceed the available insurance coverage, and (b) the releases would not apply to the extent that a court found that a releasee was guilty of fraud, willful misconduct or gross negligence;
- The releases were the product of "hard-fought" and "arm's-length" negotiations among the Debtors, the secured lender and the Official Committee of Unsecured Creditors;
- The releases were critical to gaining support for the Plan and were "necessary and integral" components of the Plan;
- The beneficiaries of the proposed releases had contributed to the sale of the Debtors' remaining operating businesses, had maximized the values of the Debtors' assets, had made better creditor recoveries possible, and had prevented a conversion to chapter 7;
- The Debtors would receive reciprocal releases from the releasees;
- Certain of the parties to be released had continued to work despite facing personal risks following the seizure of the Debtors' assets in Nicaragua by Nicaraguan authorities;
- Some of the individuals who would receive releases did not have managerial control "outside of their local country" and did not handle corporate-level accounting and financing;
- Some of the proposed beneficiaries of the releases live in foreign countries, where it would be difficult and expensive to prosecute a claim and to collect on a claim;
- The Debtors (and Mr. Light in particular) had evaluated the potential claims against the released parties and had considered the relative merits and economic benefit of any potential claims, and in light of "the past and ongoing contributions" of the released

parties and "efforts to maximize recovery for the creditors" the Debtors had concluded that the releases should be approved;

- No creditors objected to the proposed releases; and
- Debtors have considerable leeway in granting releases of their own claims and such releases should be approved so long as the Debtors exercise reasonable business judgment.

See Second Amended Disclosure Statement, ECF No. 489 at 97–98; Debtors' Memorandum of Law in Support of Confirmation, ECF No. 588 at ¶¶ 84–85; Declaration of Harve Light in Support of Plan Confirmation, ECF No. 589 at ¶¶ 29–32; Debtors' Memorandum in Opposition to the UST Objection, ECF No.638 at 2–3, 9–11; Supplemental Declaration of Harve Light, ECF No. 639 at ¶¶ 22–23; Supplemental Declaration of Harve Light, ECF No. 645 at ¶¶ 7, 8, 12. The Debtors stated that they recognized that releases would not necessarily be warranted just for doing a good job, but contended that the proposed releasees had done more in these cases:

> The Debtors recognize that releases are not necessarily warranted for a job well done, but the Released Parties have done more than meet expectations. The Released Parties continued to provide critical support even in the fact of serious risk to their own personal safety and risk to the personal safety of their families. While directors and officers often steer businesses through crises, that exercise does not typically require that those directors and officers subject themselves and their families to serious, personal harm. Under these specific circumstances, the Debtor Release is reasonable, particularly because it does not bar potential claims of the Debtors against the directors and officers, but only limits their personal liability. Given the circumstances of these Chapter 11 Cases, the Debtor Release and Release Limitation are reasonable and represent a sound exercise of the Debtors' business judgment.

Debtors' Memorandum in Opposition to the UST Objection, ECF No. 638 at 11.

In his most recent declaration (ECF No. 645), filed the day before the confirmation hearing, Mr. Light stated that the 19 individuals who would be the beneficiaries of releases fall into three categories: (a) those who did not have managerial control "outside of their local country" and did not have direct responsibility or control of the global company or its finances; (b) individuals who "made significant contributions to the attempted sale and financing activities or went above and beyond in their efforts to maximize the value of assets as we liquidated them;" and (c) individuals as to whom Mr. Light believed "there would be no tangible economic benefit in pursuing them" because they are located outside the United States and the expense of obtaining and enforcing a judgment would not make sense. *Id.* at ¶¶ 7, 8, 12. Some individuals are listed in more than one category. *Id.* at Ex. A.

The confirmation hearing was held on June 28, 2024. During the hearing I asked for clarification of some of the arguments that the Debtors had made in their prior submissions.

The Debtors had contended (and continued to argue at the hearing) that the releases had been the result of "hard-fought" and "arm's-length" negotiations. I asked for clarification of why this was a "hard-fought" issue, and more particularly "[w]ho was arguing in favor of the releases and why?" ECF No. 669, Tr., 6/28/2024 at 15:10-13. Counsel stated that the Debtors had sought the releases, and that they did so in order to "keep the company from going into a Chapter 7 liquidation." *Id.* at 15:14-18.

I then posed the following question:

> Help me with – all of this is presented. At times it suggests that it was a trade-off, that they were promised releases in exchange for the work that they did or that they were promised releases before the sales occurred. What's the sequence here? I don't really know what to make of it because the plan was proposed after the sales were basically accomplished. Are they bonuses? Are they deals that you made beforehand? Help me with the sequence.

Id. at 15:19-16:1. Counsel responded by saying that during the case the promise of releases was an inducement to continue work and that "a critical mass" of employees had been prepared to leave the company in late February and early March, when asset sales had not yet been finished and when the terms of the Plan were being negotiated. *Id.* at 16:2-25. When I asked why releases were proposed for employees who were not working on the ongoing sales, counsel responded that it was "an integrated plan settlement." *Id.* at 17:17-18. I said that I remained confused as to whether the releases were being proposed as a suggested "bonus" for prior work or whether the Debtors were seeking the approval of releases in fulfilment of a prior deal. Counsel responded that the individuals in Category 2 (those working on ongoing sales) had said that if the releases weren't approved they would leave the company in late February/early March, and if that had happened the company could not have continued to operate and could not have completed the sales that occurred. *Id.* at 20:10-21:5.

Counsel to the Creditors' Committee confirmed the Debtors' counsel's account of the prior discussions, but said they had occurred in April and May rather than in February and March. *Id.* at 21:13-22. Rabobank (the secured lender) confirmed that it had believed there was a high risk that individuals would have departed and that Rabobank had agreed to support the releases "to get out of Chapter 11 and conclude this liquidation as quickly as possible, given the overall costs of the process." *Id.* at 22:22-23:8.

The Debtors' prior submissions contended that the Debtors had investigated the claims that were being released. I asked the Debtors' counsel, at the confirmation hearing, to explain what investigation had been done. The Debtors' counsel argued that Mr. Light had been involved with the Debtors since April 2023 and was involved in an investigation of certain accounting issues that had resulted in a default on bank debt, and that accountants had been excluded from the releases as a result. Counsel also stated that during the prior two years the proposed releasees had not received dividends or incentive compensation and had not had a significant increase in their base compensation. He also argued that the Debtors know the residences of the releasees and that in some cases their foreign residence would complicate the pursuit and collection of claims. *Id.* at 26:14-21. But counsel then added:

> I'll be very candid with the Court. There wasn't an investigation in the sense of there being thousands and thousands of documents that were produced in discovery or reviewed internally. There certainly wasn't any of that kind of formal investigation. But there was a high level of familiarity with the overall facts and circumstances. And with the releases narrowed to what they are now, belief was when you – there wouldn't be a justification, any additional cost for creating such a call it formal investigation. Nor was there the belief that there would be authority to use cash collateral to conduct such an investigation.

Id. at 26:22-27:2. Committee counsel confirmed that the Committee also had done no investigation as to the claims being released. *Id.* at 22:5-17.

During the hearing I expressed reservations about the theory that was being offered in support of the proposed releases, at least to the extent that such releases were being proposed in favor of "insiders." The primary justification for the releases was that some of the recipients had threatened to terminate their employment if the parties did not commit to seek the releases. I asked whether the provisions of section 503(c) of the Bankruptcy Code should apply to the extent the releases were proposed in order to retain the services of insiders. *Id.* at 27:8-11. After I reviewed the requirements of section 503(c), Counsel acknowledged that if section 503(c) were applicable then the Debtors "won't be able to meet these other elements" for approval of the releases as to insiders. *Id.* at 29:9-12. I asked counsel to confirm whether the Debtors received any consideration for the releases other than the continued work by the proposed releasees, and counsel responded that "I don't know that we got anything else from them other than their continued services they were getting. But the estate certainly got a significant benefit." *Id.* at 29:20-30:3.

I expressed reluctance to renege on deals that had previously been made but I expressed concern that if the issue had been presented to me in February or March 2024 (when the agreements to include the proposed releases in the Plan had been reached), and if the explanation then had been that the releases were necessary for the continued retention of the employees, I would have had to apply the standards of section 503(c) in deciding whether the releases could be granted. *Id.* at 30:4-14. After further argument I gave the Debtors "another chance" to identify whether "something other than the retention of the employees is the consideration for the releases -- or is there any other contention that there was anything else that's the consideration for the releases?" *Id.* at 35:6-10. Counsel responded that "the argument that I've made so far is that – our case." *Id.* at 35:11-12.

I noted that individuals who were not "insiders" would not be subject to some of the rigorous approval standards of section 503(c), that the "factual showing" as to the non-insiders was "to be honest, was a little thin," but that I would approve those releases. *Id.* at 35:13-25, 38:5-8. I also gave the parties the opportunity to make further submissions to me on the issue of whether section 503(c) would apply to the approval of the releases in favor of those releases who were "insiders." The parties have now made those submissions. ECF Nos. 660, 664, 666.

The Debtors argue in their post-hearing submission (ECF No. 660) that section 503(c) only applies to the allowance and payment of administrative expenses and that the grant of a release is not the payment of an administrative expense. *Id.* at 1–4. By its terms, however, section 503(c) states that a "transfer" or "obligation" for the benefit of an insider, made for the purpose of inducing such person to remain with the debtor's business, shall neither be "allowed" nor "paid" except in compliance with the requirements of section 503(c). 11 U.S.C. § 503(c). The statute applies to post-petition "transfers" and "obligations" generally, not just to cash payments. Surely nobody would contend, for example, that section 503(c) could be evaded just by agreeing to provide an insider with some form of property other than cash, such as a new home or a new car.

The grant of a release is a disposition of a party's interest in property (legal claims) and therefore is a "transfer." *See* 11 U.S.C. § 101(54) (defining a "transfer" as including any mode, direct or indirect, of disposing or parting with property or an interest in property). The Debtors' counsel conceded during the confirmation hearing that a release is a "transfer" of property rights, even if it is not a transfer of cash. ECF No. 669, Tr. 6/28/2024, at 31:8-22, 36:8-17. The proposed releases here would be post-petition "transfers" of claims that belong to the estate, and they are being proposed pursuant to a post-petition "obligation" that the parties undertook in order to induce the insiders' continued employment. Section 503(c) cannot be evaded simply by alleging that the relevant post-petition "transfer" and "obligation" involve the delivery of something other than money.

The Debtors also argue that section 1123(b)(3) and Rule 9019 generally permit the settlement of claims that belong to Debtors. ECF No. 660 at 5–8. However, there is no suggestion in sections 1123(b)(3) or Rule 9019 that a Debtor's general authority to seek the approval of a compromise can be used to circumvent the far more specific provisions of section 503(c). Certainly, for example, the Debtors could not argue that the "business judgment" standards that are ordinarily applied under Rule 9019 would have supplanted the provisions of section 503(c) if the Debtors had sought my approval of the releases several months ago. Nor is there anything in section 1123(b)(3) that implies that the provisions of section 503(c) can be ignored so long as the approval of a retention payment is sought, in hindsight, through a proposed plan. Judge Lane rejected a somewhat similar argument in the American Airlines bankruptcy, in which parties contended that a severance payment to an executive could be approved pursuant to section 1129(a)(4) of the Bankruptcy Code and without compliance with the terms of section 503(c). *In re AMR Corp.*, 497 B.R. 690, 696–97 (Bankr. S.D.N.Y. 2013) (holding that section 1129(a)(1) requires that a plan comply with all applicable provisions of the Bankruptcy Code and that if that instruction "means anything, the Court cannot approve a payment that is clearly prohibited by another, more specific part of the Bankruptcy Code."). I agree. Section 1129(a)(1) states that the confirmation of a Plan can only be granted if the Plan "complies with the applicable provisions" of the Bankruptcy Code, 11 U.S.C. § 1129(a)(1), and that includes section 503(c).

Finally, the Debtors argue that the releases are being offered after the fact – months after the relevant agreements to include the releases in the Plan, after the relevant services have been performed and therefore after the insiders' consideration has already been provided. In the Debtors' view, this means that the releases are not being offered as forward-looking "inducements" for the continued future employment of the individuals. ECF No. 660 at 8–10. If I were to accept that theory, however, it would mean that a debtor could avoid the application of section 503(c) in its entirety by entering into a KERP agreement with insiders and just delaying the request for court approval of the KERP until plan confirmation, at which point the insiders would already have provided the continued service that the KERP contemplated. Section 503(c) would have little meaning if it could be so easily evaded.

There is no contention in this case that the proposed releases are in consideration of any post-confirmation work that the releasees might provide. Instead, the parties admittedly made a post-petition commitment to support the proposed releases in order to induce continued employment. The fact that the releases were meant to "induce" continued employment did not change just because the court approval of the releases is only being sought in hindsight.

I have sympathy for the insiders, who did good work and who did in many cases faced hardships and personal risks. But I am constrained by the terms of the Bankruptcy Code and I am not free to ignore its relevant provisions. The Debtors, with commendable honesty, have made clear that the sole consideration for the proposed releases in favor of the insiders was their agreement to remain in the Debtors' employment, and that the other parties had agreed to seek such releases in order to induce such continued employment. Although the Debtors argue that the releases are supported by reasonable business judgments, they have conceded that the more exacting standards of section 503(c) have not been met. I have no choice in light of these concessions but to deny approval of the proposed releases insofar as they would apply to insiders.

In its post-hearing submission, the UST asserts that all 19 of the proposed beneficiaries of the release are "insiders," but that is not what the parties contended at the hearing and it is not what is stated in the supporting declarations (which were admitted into evidence without objection and without any request by the UST to conduct cross-examination). It was clear at the confirmation hearing that only some of the purported releasees were "insiders," and I ruled that I would grant the releases as to the non-insiders. ECF No. 669, Tr., 6/28/2024, at 38:4-8. However, the relevant portion of the transcript of the confirmation hearing, in which the Debtors' counsel identified the persons who were "insiders," is garbled. The transcript suggests that the Debtors' counsel identified all of the individuals whose names fall into categories 1 and 2 of Exhibit A to Mr. Light's June 27, 2024 Supplemental Declaration (ECF No. 645, Ex. A) as "insiders." *See Id.* at 34:7-12. However, Category 1 included individuals who allegedly had no management responsibilities, and my own recollection of the hearing is that the Debtors represented that the "insiders" were people whose names appeared in Category 2 but did *not* appear in Category 1. A clarification plainly is needed. The Debtors and the UST are hereby directed to confer as to the identification of those proposed releasees who were "insiders," and if they are unable to reach agreement I will make such further rulings as may be required.

During the confirmation hearing the Debtors suggested that they might propose a limitation of the releases in favor of insiders, so that instead of applying to claims of all kinds (with limitations for claims covered by insurance) the releases would apply only to those claims that are otherwise covered by insurance. The effect of such a limit would be that the releases would limit the individuals' personal liabilities for those claims for which insurance is available, without releasing other claims. In theory a more limited release of this kind might have other justifications in terms of facilitating the pursuit of claims that are covered by insurance. The Debtors have not made that proposed change, however, and I will make no rulings as to that possibility unless and until such a plan modification is actually proposed.

Conclusion

For the foregoing reasons, the UST's objections to confirmation of the Plan are overruled, except that the proposed releases of the Debtors' claims in favor of those individuals who are "insiders" will be denied. This ruling is without prejudice to such further plan modifications as the Debtors may wish to propose or as to such different justifications for such modified release provisions that that the Debtors may wish to propose. The UST and the Debtors are directed to agree upon the list of individuals who are "insiders" for purposes of this ruling and on the terms of an Order incorporating the Court's rulings. If they cannot agree, the Court will schedule such further proceedings as may be appropriate.

Dated: New York, New York
July 19, 2024

/s/ **Michael E. Wiles**
Honorable Michael E. Wiles
United States Bankruptcy Judge

United States Court of Appeals
for the Fifth Circuit

United States Court of Appeals
Fifth Circuit
FILED
September 7, 2022
Lyle W. Cayce
Clerk

No. 21-10449

In the Matter of: Highland Capital Management, L.P.,

Debtor,

NexPoint Advisors, L.P.; Highland Capital Management Fund Advisors, L.P.; Highland Income Fund; NexPoint Strategic Opportunities Fund; Highland Global Allocation Fund; NexPoint Capital, Incorporated; James Dondero; The Dugaboy Investment Trust; Get Good Trust,

Appellants,

versus

Highland Capital Management, L.P.,

Appellee.

Appeal from the United States Bankruptcy Court
for the Northern District of Texas
USDC No. 19-34054
USDC No. 3:21-CV-538

Before Wiener, Graves, and Duncan, *Circuit Judges*.

ON PETITION FOR REHEARING

STUART KYLE DUNCAN, *Circuit Judge*:

The petition for panel rehearing is GRANTED. We withdraw our previous opinion, reported at 2022 WL 3571094, and substitute the following:

Highland Capital Management, L.P., a Dallas-based investment firm, managed billion-dollar, publicly traded investment portfolios for nearly three decades. By 2019, however, myriad unpaid judgments and liabilities forced Highland Capital to file for Chapter 11 bankruptcy. This provoked a nasty breakup between Highland Capital and its co-founder James Dondero. Under those trying circumstances, the bankruptcy court successfully mediated with the largest creditors and ultimately confirmed a reorganization plan amenable to most of the remaining creditors.

Dondero and other creditors unsuccessfully objected to the confirmation order and then sought review in this court. In turn, Highland Capital moved to dismiss their appeal as equitably moot. First, we hold that equitable mootness does not bar our review of any claim. Second, we affirm the confirmation order in large part. We reverse only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), strike those few parties from the plan's exculpation, and affirm on all remaining grounds.

I. BACKGROUND

A. Parties

In 1993, Mark Okada and appellant James Dondero co-founded Highland Capital Management, L.P. ("Highland Capital") in Dallas. Highland Capital managed portfolios and assets for other investment advisers and funds through a complex of entities under the Highland umbrella. Highland Capital's ownership-interest holders included Hunter Mountain Investment Trust (99.5%); appellant The Dugaboy Investment

Trust, Dondero's family trust (0.1866%);[1] Okada, personally and through trusts (0.0627%); and Strand Advisors, Inc. (0.25%), the only general partner, which Dondero wholly owned.

Dondero also manages two of Highland Capital's clients—appellants Highland Capital Management Fund Advisors, L.P. and NexPoint Advisors, L.P. (the "Advisors"). Both the Advisors and Highland Capital serviced and advised billion-dollar, publicly traded investment funds for appellants Highland Income Fund, NexPoint Strategic Opportunities Fund, Highland Global Allocation Fund, and NexPoint Capital, Inc. (collectively, the "Funds"), among others. For example, on behalf of the Funds, Highland Capital managed certain investment vehicles known as collateral loan obligations ("CLOs") under individualized servicing agreements.

B. Bankruptcy Proceedings

Strapped with a series of unpaid judgments, Highland Capital filed for Chapter 11 bankruptcy in the District of Delaware in October 2019. The creditors included Highland Capital's interest holders, business affiliates, contractors, former partners, employees, defrauded investors, and unpaid law firms. Among those creditors, the Office of the United States Trustee appointed a four-member Unsecured Creditors' Committee (the "Committee").[2] *See* 11 U.S.C. § 1102(a)(1), (b)(1). Throughout the

[1] The Dugaboy Investment Trust appeals alongside Dondero's other family trust Get Good Trust (collectively, the "Trusts").

[2] First, Redeemer Committee of the Highland Crusader Fund had obtained a $191 million arbitration award after a decade of litigation against Highland Capital. Second, Acis Capital Management, L.P. and Acis Capital Management GP, LLC had sued Highland Capital after facing an adverse $8 million arbitration award, arising in part from its now-extinguished affiliation. Third, UBS Securities LLC and UBS AG London Branch had received a $1 billion judgment against Highland Capital following a 2019 bench trial in New

bankruptcy proceedings, the Committee investigated Highland Capital's past and current operations, oversaw its continuing operations, and negotiated the reorganization plan. *See id.* § 1103(c). Upon the Committee's request, the court transferred the case to the Northern District of Texas in December 2019.

Highland Capital's reorganization did not proceed under the governance of a traditional Chapter 11 trustee. Instead, the Committee reached a corporate governance settlement agreement to displace Dondero, which the bankruptcy court approved in January 2020. Under the agreed order, Dondero stepped down as director and officer of Highland Capital and Strand to be an unpaid portfolio manager and "agreed not to cause any Related Entity . . . to terminate any agreements" with Highland Capital. The Committee selected a board of three independent directors to act as a quasi-trustee and to govern Strand and Highland Capital: James Seery Jr., John Dubel, and retired Bankruptcy Judge Russell Nelms (collectively, the "Independent Directors"). The order also barred any claim against the Independent Directors in their official roles without the bankruptcy court's authorizing the claim as a "colorable claim[] of willful misconduct or gross negligence." Six months later, at the behest of the creditors, the bankruptcy court appointed Seery as Highland Capital's Chief Executive Officer, Chief Restructuring Officer, and Foreign Representative. The order contained an identical bar on claims against Seery acting in these roles. Neither order was appealed.

Throughout summer 2020, Dondero proposed several reorganization plans, each opposed by the Committee and the Independent Directors.

York. Fourth, discovery vendor Meta-E Discovery had $779,000 in unpaid invoices. The Committee members are not parties on appeal.

Unpersuaded by Dondero, the Committee and Independent Directors negotiated their own plan. When Dondero's plans failed, he and other creditors began to frustrate the proceedings by objecting to settlements, appealing orders, seeking writs of mandamus, interfering with Highland Capital's management, threatening employees, and canceling trades between Highland Capital and its clients. *See Highland Cap. Mgmt., L.P. v. Dondero (In re Highland Cap. Mgmt., L.P.)*, Ch. 11 Case No. 19-34054-SGJ11, Adv. No. 20-03190-SGJ11, 2021 WL 2326350, at *1, *26 (Bankr. N.D. Tex. June 7, 2021) (holding Dondero in civil contempt, sanctioning him $100,000, and comparing this case to a "nasty divorce"). In Seery's words, Dondero wanted to "burn the place down" because he did not get his way. The Independent Directors insisted Dondero resign from Highland Capital, which he did in October 2020.

Highland Capital, meanwhile, proceeded toward confirmation of its reorganization plan—the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (the "Plan"). In August 2020, the Independent Directors filed the Plan and an accompanying disclosure statement with the support of the Committee. *See* 11 U.S.C. §§ 1121, 1125. The bankruptcy court approved the statement as well as proposed notice and voting procedures for creditors, teeing up confirmation. Leading up to the confirmation hearing, the Advisors and the Funds asked the court to bar Highland Capital from trading or disposing of CLO assets pending confirmation. The bankruptcy court denied the request, and Highland Capital declined to voluntarily abstain and continued to manage the CLO assets.

Before confirmation, Dondero and other creditors (including several non-appellants) filed over a dozen objections to the Plan. Like Dondero, the United States Trustee primarily objected to the Plan's exculpation of certain non-debtors as unlawful. Highland Capital voluntarily modified the Plan to resolve six such objections. The Plan proposed to create eleven classes of creditors and equity holders and three classes of administrative claimants. *See* 11 U.S.C. § 1122. Of the voting-eligible classes, classes 2, 7, and 9 voted to accept the Plan while classes 8, 10, and 11 voted to reject it.

C. Reorganization Plan

The Plan works like this: It dissolves the Committee, and creates four entities—the Claimant Trust, the Reorganized Debtor, HCMLP GP LLC,[3] and the Litigation Sub-Trust. Administered by its trustee Seery, the Claimant Trust "wind[s]-down" Highland Capital's estate over approximately three years by liquidating its assets and issuing distributions to class-8 and -9 claimants as trust beneficiaries. Highland Capital vests its ongoing servicing agreements with the Reorganized Debtor, which "among other things" continues to manage the CLOs and other investment portfolios. The Reorganized Debtor's only general partner is HCMLP GP LLC. And the Litigation Sub-Trust resolves pending claims against Highland Capital under the direction of its trustee Marc Kirschner.

The whole operation is overseen by a Claimant Trust Oversight Board (the "Oversight Board") comprised of four creditor representatives and one restructuring advisor. The Claimant Trust wholly owns the limited partnership interests in the Reorganized Debtor, HCMLP GP LLC, and the Litigation Sub-Trust. The Claimant Trust (and its interests) will dissolve either at the soonest of three years after the effective date (August 2024) or (1) when it is unlikely to obtain additional proceeds to justify further action, (2) all claims and objections are resolved, (3) all distributions are made, and (4) the Reorganized Debtor is dissolved.

[3] The Plan calls this entity "New GP LLC," but according to the motion to dismiss as equitably moot, the new general partner was later named HCMLP GP LLC. For the sake of clarity, we use HCMLP GP LLC.

Anticipating Dondero's continued litigiousness, the Plan shields Highland Capital and bankruptcy participants from lawsuits through an exculpation provision, which is enforced by an injunction and a gatekeeper provision (collectively, "protection provisions"). The protection provisions extend to nearly all bankruptcy participants: Highland Capital and its employees and CEO; Strand; the Independent Directors; the Committee; the successor entities and Oversight Board; professionals retained in this case; and all "Related Persons"[4] (collectively, "protected parties").[5]

The Plan exculpates the protected parties from claims based on any conduct "in connection with or arising out of" (1) the filing and administration of the case, (2) the negotiation and solicitation of votes preceding the Plan, (3) the consummation, implementation, and funding of the Plan, (4) the offer, issuance, and distribution of securities under the Plan before or after the filing of the bankruptcy, and (5) any related negotiations, transactions, and documentation. But it excludes "acts or omissions that constitute bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct" *and* actions by Strand and its employees predating the appointment of the Independent Directors.

Under the Plan, bankruptcy participants are enjoined "from taking any actions to interfere with the implementation or consummation of the

[4] The Plan generously defines "Related Persons" to include all former, present, and future officers, directors, employees, managers, members, financial advisors, attorneys, accountants, investment bankers, consultants, professionals, advisors, shareholders, principals, partners, heirs, agents, other representatives, subsidiaries, divisions, and managing companies.

[5] The Plan expressly excludes from the protections Dondero and Okada; NexPoint Advisors, L.P.; Highland Capital Management Fund Advisors, L.P; their subsidiaries, managed entities, managed entities, and members; and the Dugaboy Investment Trust and its trustees, among others.

Plan" or filing any claim related to the Plan or proceeding. Should a party seek to bring a claim against any of the protected parties, it must go to the bankruptcy court to "first determin[e], after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind." Only then may the bankruptcy court "specifically authoriz[e]" the party to bring the claim. The Plan reserves for the bankruptcy court the "sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable" and then to adjudicate the claim if the court has jurisdiction over the merits.

D. Confirmation Order

At a February 2021 hearing, the bankruptcy court confirmed the Plan from the bench over several remaining objections. *See* Fed R. Bankr. P. 3017–18; 11 U.S.C. §§ 1126, 1128, 1129. In its later-written decision, the bankruptcy court observed that Highland Capital's bankruptcy was "not a garden variety chapter 11 case." The type of debtor, the reason for the bankruptcy filing, the kinds of creditor claims, the corporate governance structure, the unusual success of the mediation efforts, and the small economic interests of the current objectors all make this case unique.

The confirmation order criticized Dondero's behavior before and during the bankruptcy proceedings. The court could not "help but wonder" if Highland Capital's deficit "was necessitated because of enormous litigation fees and expenses incurred" due to Highland Capital's "culture of litigation." Recounting Highland Capital's litigation history, it deduced that Dondero is a "serial litigator." It reasoned that, while "Dondero wants his company back," this "is not a good faith basis to lob objections to the Plan." It attributed Dondero's bad faith to the Advisors, the Trusts, and the Funds, given the "remoteness of their economic interests." For example, the bankruptcy court "was not convinced of the[] [Funds'] independence" from Dondero because the Funds' board members did not testify and had "engaged with the Highland complex for many years." And so the bankruptcy court "consider[ed] them all to be marching pursuant to the orders of Mr. Dondero." The court, meanwhile, applauded the members of the Committee for their "wills of steel" for fighting "hard before and during this Chapter 11 Case" and "represent[ing] their constituency . . . extremely well."

On the merits of the Plan, the bankruptcy court again approved the Plan's voting and confirmation procedures as well as the fairness of the Plan's classes. *See* 11 U.S.C. §§ 1122, 1125(a)–(c). The court held the Plan complied with the statutory requirements for confirmation. *See id.* §§ 1123(a)(1)–(7), 1129(a)(1)–(7), (9)–(13). Because classes 8, 10, and 11 had voted to reject the Plan, it was confirmable only by cramdown.[6] *See id.* § 1129(b). The bankruptcy court found that the Plan treated the dissenting classes fairly and equitably and satisfied the absolute-priority rule, so the Plan was confirmable. *See id.* § 1129(b)(2)(B)–(C). The court also concluded that the protection provisions were fair, equitable, and reasonable, as well as "integral elements" of the Plan under the circumstances, and were within both the court's jurisdiction and authority. The court confirmed the Plan as proposed and discharged Highland Capital's debts. *Id.* § 1141(d)(1). After confirmation and satisfaction of several conditions precedent, the Plan took effect August 11, 2021.

[6] The bankruptcy court must proceed by nonconsensual confirmation, or "cramdown," 11 U.S.C. § 1129(b), when a class of unsecured creditors rejects a Chapter 11 reorganization plan, *id.* § 1129(a)(8), but at least one impaired class accepts it, *id.* § 1129(a)(10). A cramdown requires that the plan be "fair and equitable" to dissenting classes and satisfy the absolute priority rule—that is, dissenting classes are paid in full before any junior class can retain any property. *Id.* § 1129(b)(2)(B); *see Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 441–42 (1999).

E. The Appeal

Dondero, the Advisors, the Funds, and the Trusts (collectively, "Appellants") timely appealed, objecting to the Plan's legality and some of the bankruptcy court's factual findings.[7] Together with Highland Capital, Appellants moved to directly appeal the confirmation order to this court, which the bankruptcy court granted. *See* 28 U.S.C. § 158(d). A motions panel certified and consolidated the direct appeals. *See ibid.* Both the bankruptcy court and the motions panel declined to stay the Plan's confirmation pending appeal. Given the Plan's substantial consummation since its confirmation, Highland Capital moved to dismiss the appeal as equitably moot, a motion the panel ordered carried with the case.

* * *

We first consider equitable mootness and decline to invoke it here. We then turn to the merits, conclude the Plan exculpates certain non-debtors beyond the bankruptcy court's authority, and affirm in all other respects.

II. Standard of Review

A confirmation order is an appealable final order, over which we have jurisdiction. *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502 (2015); *see* 28 U.S.C. §§ 158(d), 1291. This court reviews a bankruptcy court's factual findings for clear error and legal conclusions *de novo*. *Evolve Fed. Credit Union v. Barragan-Flores (In re Barragan-Flores)*, 984 F.3d 471, 473 (5th Cir. 2021) (citation omitted).

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[7] The Trusts adopt the Funds' and the Advisors' briefs in full, and Dondero adopts the Funds' brief in full and the Advisors' brief in part. Fed. R. App. P. 28(i).

III. Equitable Mootness

Highland Capital moved to dismiss this appeal as equitably moot. It argues we should abstain from appellate review because clawing back the implemented Plan "would generate untold chaos." We disagree and deny the motion.

The judge-made doctrine of equitable mootness allows appellate courts to abstain from reviewing bankruptcy orders confirming "complex plans whose implementation has substantial secondary effects." *New Indus., Inc. v. Byman (In re Sneed Shipbuilding, Inc.)*, 916 F.3d 405, 409 (5th Cir. 2019) (citing *In re Trib. Media Co.*, 799 F.3d 272, 274, 281 (3d Cir. 2015)). It seeks to balance "the equitable considerations of finality and good faith reliance on a judgment" and "the right of a party to seek review of a bankruptcy order adversely affecting him." *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994) (quoting *First Union Real Estate Equity & Mortg. Inv. v. Club Assocs. (In re Club Assocs.)*, 956 F.3d 1065, 1069 (11th Cir. 1992)); *see In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008); *see also* 7 Collier on Bankruptcy ¶ 1129.09 (16th ed.), LexisNexis (database updated June 2022) (observing "the equitable mootness doctrine is embraced in every circuit").[8]

This court uses equitable mootness as a "scalpel rather than an axe," applying it claim-by-claim, instead of appeal-by-appeal. *In re Pac. Lumber*

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[8] The doctrine's atextual balancing act has been criticized. *See In re Pac. Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009) ("Despite its apparent virtues, equitable mootness is a judicial anomaly."); *In re One2One Commc'ns, LLC*, 805 F.3d 428, 438–54 (3rd Cir. 2015) (Krause, J., concurring); *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (banishing the term "equitable mootness" as a misnomer); *In re Cont'l Airlines*, 91 F.3d 553, 569 (3d Cir. 1996) (en banc) (Alito, J., dissenting); *see also* Bruce A. Markell, *The Needs of the Many: Equitable Mootness' Pernicious Effects*, 93 Am. Bankr. L.J. 377, 393–96 (2019) (addressing the varying applications between circuits). *But see In re Trib. Media*, 799 F.3d at 287–88 (Ambro, J., concurring) (highlighting some benefits of the equitable mootness doctrine).

Co.(Pacific Lumber), 584 F.3d 229, 240–41 (5th Cir. 2009). For each claim, we analyze three factors: "(i) whether a stay has been obtained, (ii) whether the plan has been 'substantially consummated,' and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan." *In re Manges*, 29 F.3d at 1039 (citing *In re Block Shim Dev. Co.*, 939 F.2d 289, 291 (5th Cir. 1991); and *Cleveland, Barrios, Kingsdorf & Casteix v. Thibaut*, 166 B.R. 281, 286 (E.D. La. 1994)); *see also, e.g.*, *In re Blast Energy Servs.*, 593 F.3d 418, 424–25 (5th Cir. 2010); *In re Ultra Petroleum Corp.*, No. 21-20049, 2022 WL 989389, at *5 (5th Cir. Apr. 1, 2022). No one factor is dispositive. *See In re Manges*, 29 F.3d at 1039.

Here, the bankruptcy court and this court declined to stay the Plan pending appeal, and it took effect August 11, 2021. Given the months of progress, no party meaningfully argues the Plan has not been substantially consummated.[9] *See Pacific Lumber*, 584 F.3d at 242 (observing "consummation includes transferring all or substantially all of the property

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[9] Since the Plan's effectuation, Highland Capital paid $2.2 million in claims to a committee member and $525,000 in "cure payments" to other counterparties. The independent directors resigned. The Reorganized Debtor, the Claimant Trust, HCMLP GP LLC, and the Litigation Sub-Trust were created and organized in accordance with the Plan. The bankruptcy court appointed the Oversight Board members, the Litigation Sub-Trust trustee, and the Claimant Trust trustee. Highland Capital assumed certain service contracts, including management of twenty CLOs with approximately $700 million in assets, and transferred its assets and estate claims to the successor entities. Highland Capital's pre-petition partnership interests were cancelled and cease to exist. A third party, Blue Torch Capital, infused $45 million in exit financing, fully guaranteed by the Reorganized Debtor, its operating subsidiaries, the Claimant Trust, and most of their assets. From the exit financing, an Indemnity Trust was created to indemnify claims that arise against the Reorganized Debtor, Claimant Trust, Ligation Sub-Trust, Claimant Trustee, Litigation Trustee, or Oversight Board members. The lone class-1 creditor withdrew its claim against Highland Capital. The lone class-2 creditor has been fully paid approximately $500,000 and issued a note of $5.2 million secured by $23 million of the Reorganized Debtor's assets. Classes 3 and 4 have been paid $165,412. Class 7 has received $5.1 million in distributions from the Claimant Trust, totaling 77% of class-7 claims filed.

covered by the plan, the assumption of business by the debtors' successors, and the commencement of plan distributions" (citing 11 U.S.C. § 1141; and *In re Manges*, 29 F.3d at 1041 n.10)). But that alone does not trigger equitable mootness. *See In re SCOPAC*, 624 F.3d 274, 281–82 (5th Cir. 2010). Instead, for each claim, the inquiry turns on whether the court can craft relief for that claim that would not have significant adverse consequences to the reorganization. Highland Capital highlights four possible disruptions: (1) the unraveling of the Claimant Trust and its entities, (2) the expense of disgorging disbursements, (3) the threat of defaulting on exit-financing loans, and (4) the exposure to vexatious litigation.

Each party first suggests its own all-or-nothing equitable mootness applications. To Highland Capital, Appellants' broad requested remedy with only a minor economic stake demands mooting the entire appeal. To Appellants, the type of reorganization plan categorially bars equitable mootness, or, alternatively, Highland Capital's joining the motion to certify the appeal estops it from asserting equitable mootness. These arguments are unpersuasive and foreclosed by *Pacific Lumber*.

First, Highland Capital contends the entire appeal is equitably moot because Appellants, with only a minor economic stake and questionable good faith, "seek[] nothing less than a complete unravelling of the confirmed Plan." It claims the court cannot "surgically excise[]" certain provisions, as the Funds request, because the Bankruptcy Code prohibits "modifications to confirmed plans after substantial consummation." *See* 11 U.S.C. § 1127(b). Not so.

"Although the Bankruptcy Code . . . restricts post-confirmation plan modifications, it does not expressly limit appellate review of plan confirmation orders." *Pacific Lumber*, 584 F.3d at 240 (footnote omitted) (citing 11 U.S.C. § 1127). This court may fashion "fractional relief" to minimize an appellate disturbance's effect on the rights of third parties. *In re Tex. Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324, 328 (5th Cir. 2013) (denying dismissal on equitable mootness grounds because the court "could grant partial relief . . . without disturbing the reorganization"); *cf. In re Cont'l Airlines*, 91 F.3d 553, 571–72 (3d Cir. 1996) (en banc) (Alito, J., dissenting) (observing "a remedy could be fashioned in the present case to ensure that the [debtor's] reorganization is not undermined"). In short, Highland Capital's speculations are farfetched, as the court may fashion the remedy it sees fit without upsetting the reorganization.

Second, Appellants contend that equitable mootness cannot apply—full-stop—because this appeal concerns a liquidation plan, not a reorganization plan. We reject that premise. *See infra* Part IV.A. Even if it were correct, however, this court has conducted the equitable-mootness inquiry for a Chapter 11 liquidation plan in the past. *See In re Superior Offshore Int'l, Inc.*, 591 F.3d 350, 353–54 (5th Cir. 2009). And other circuits have squarely rejected the categorical bar proposed by Appellants. *See In re Abengoa Bioenergy Biomass of Kan., LLC*, 958 F.3d 949, 956–57 (10th Cir. 2020); *In re BGI, Inc.*, 772 F.3d 102, 107–09 (2d Cir. 2014). We do the same.

Finally, Appellants assert that because Highland Capital and NexPoint Advisors, L.P. jointly moved to certify the appeal, it should be estopped from arguing the appeal is equitably moot. They cite no legal support for that approach. We decline to adopt it.

Instead, we proceed with a claim-by-claim analysis, as our precedent requires. Highland Capital suggests only two claims are equitably moot: (1) the protection-provisions challenge and (2) the absolute-priority-rule challenge. Neither provides a basis for equitable mootness.

For the protection provisions, Highland Capital anticipates that, without the provisions, its officers, employees, trustees, and Oversight Board members would all resign rather than be exposed to Dondero-initiated litigation. Those resignations would disrupt the Reorganized Debtor's operation, "significant[ly] deteriorat[ing] asset values due to uncertainty." Appellants disagree, offering several instances when this court has reviewed release, exculpation, and injunction provisions over calls for equitable mootness. *See, e.g.*, *In re Hilal*, 534 F.3d at 501; *Pacific Lumber*, 584 F.3d at 252; *In re Thru Inc.*, 782 F. App'x 339, 341 (5th Cir. 2019) (per curiam). In response, Highland Capital distinguishes this case because the provisions are "integral to the consummated plans." *See In re Charter Commc'ns, Inc.*, 691 F.3d 476, 486 (2d Cir. 2012). We again reject that premise. *See infra* Part IV.E.1. In any event, Appellants have the better argument.

We have before explained that "equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process." *In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008). That is so because "the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the process." *Pacific Lumber*, 584 F.3d at 252. As in *Pacific Lumber*, the legality of a reorganization plan's non-consensual non-debtor release is consequential to the Chapter 11 process and so should not escape appellate review in the name of equity. *Ibid.* The same is true here. Equitable mootness does not bar our review of the protection provisions.

For the absolute-priority-rule challenge,[10] Highland Capital contends our review requires us to "rejigger class recoveries." *Pacific Lumber* is again instructive. There, the court declined to apply equitable mootness to a secured creditor's absolute-priority-rule challenge, as no other panel had

[10] While the issue is nearly forfeited for inadequate briefing, it fails on the merits regardless. *See Roy v. City of Monroe*, 950 F.3d 245, 251 (5th Cir. 2020).

extended the doctrine so far. *Id.* at 243. Similarly, Highland Capital fails to identify a single case in which this court has declined review of the treatment of a class of creditor's claims resulting from a cramdown. *See id.* at 252. Regardless, Appellants challenge the distributions to classes 8, 10, and 11. According to Highland Capital's own declaration, "Class 8 General Unsecured Claims have received their Claimant Trust Interests." But there is no evidence that classes 10 or 11 have received any distributions. *Contra Pacific Lumber*, 584 F.3d at 251 (holding certain claims equitably moot where "the smaller unsecured creditors" had already "received payment for their claims"). As a result, the relief requested would not affect third parties or the success of the Plan. *See In re Manges*, 29 F.3d at 1039. The doctrine of equitable mootness does not bar our review of the cramdown and treatment of class-8 creditors.

We DENY Highland Capital's motion to dismiss the appeal as equitably moot.

IV. Discussion

As to the merits, Appellants fire a bankruptcy-law blunderbuss. They contest the Plan's classification as a reorganization plan, the Plan's satisfaction of the absolute priority rule, the Plan's confirmation despite Highland Capital's noncompliance with Bankruptcy Rule 2015.3, and the sufficiency of the evidence supporting the court's factual finding that the Funds are "owned/controlled" by Dondero. For each, we disagree and affirm. We do, however, agree with Appellants that the bankruptcy court exceeded its statutory authority under § 524(e) by exculpating certain non-debtors, and so we reverse and vacate the Plan only to that extent.

A. Discharge of Debt

We begin with the Plan's classification as a reorganization plan, allowing for automatic discharge of the debts. The confirmation of a Chapter

11 restructuring plan "discharges the debtor from any [pre-confirmation] debt" unless, under the plan, the debtor liquidates its assets, stops "engag[ing] in [its] business after consummation of the plan," and would be denied discharge in a Chapter 7 case. 11 U.S.C. § 1141(d)(1), (3); *see In re Sullivan*, No. 99-11107, 2000 WL 1597984, at *2 (5th Cir. Sept. 26, 2000) (per curiam). The bankruptcy court concluded Highland Capital continued to engage in business after plan consummation, so its debts are automatically discharged. The Trusts call foul because, in their view, Highland Capital's "wind down" of its portfolio management is not a continuation of its business. We disagree.

Whether a corporate debtor "engages in business" is "relatively straightforward." *Um v. Spokane Rock I, LLC*, 904 F.3d 815, 819 (9th Cir. 2018) (contrasting the more complex question for individual debtors); *see Grausz v. Sampson (In re Grausz)*, 63 F. App'x 647, 650 (4th Cir. 2003) (per curiam) (same). That is, "a business entity will not engage in business post-bankruptcy when its assets are liquidated and the entity is dissolved." *Um*, 904 F.3d at 819 (collecting cases).[11] But even a temporary continuation of business after a plan's confirmation is sufficient to discharge a Chapter 11 debtor's debt. *See In re T-H New Orleans Ltd. P'ship*, 116 F.3d 790, 804 n.15 (5th Cir. 1997) (recognizing a debtor's "conducting business for two years following Plan confirmation satisfies § 1141(d)(3)(B)" (citation omitted)). That is the case here.

[11] *See, e.g.*, *In re W. Asbestos Co.*, 313 B.R. 832, 853 (Bankr. N.D. Cal. 2003) (holding corporate debtor was not engaging in business by merely having directors and officers, rights under an insurance policy, and claims against it); *In re Wood Fam. Ints., Ltd.*, 135 B.R. 407, 410 (Bankr. D. Colo. 1989) (holding corporate debtor was not engaging in business when the plan called for liquidation and discontinuation of its business upon confirmation).

By the plain terms of the Plan, Highland Capital has and will continue its business as the Reorganized Debtor for several years. Indeed, much of this appeal concerns objections to Highland Capital's "continu[ing] to manage the assets of others." Because the Plan contemplates Highland Capital "engag[ing] in business after consummation," 11 U.S.C. § 1141(d)(1), the bankruptcy court correctly held Highland Capital was eligible for automatic discharge of its debts.[12]

B. Absolute Priority Rule

Next, we consider the Plan's compliance with the absolute-priority rule. When assessing whether a plan is "fair and equitable" in a cramdown scenario, courts must invoke the absolute-priority rule. 11 U.S.C. § 1129(b)(1); *see* 7 COLLIER ON BANKRUPTCY ¶ 1129.04. Under that rule, if a class of unsecured claimants rejects a plan, the plan must provide that those claimants be paid in full on the effective date *or* any junior interest "will not receive or retain under the plan . . . any property." 11 U.S.C. § 1129(b)(2)(B).[13]

Because class-8 claimants voted against the Plan, the bankruptcy court proceeded by nonconsensual confirmation. The court concluded the Plan was fair and equitable to class 8 and its distributions were in line with the absolute-priority rule. 11 U.S.C. § 1129(b)(2)(B). The Advisors claim the Plan violates the absolute priority rule by giving class-10 and -11 claimants a

[12] For the same reasons, we reject the Trusts' follow-on argument extending the same logic to the protection provisions.

[13] *See Pacific Lumber*, 584 F.3d at 244 (noting the rule "enforces a strict hierarchy of [creditor classes'] rights defined by state and federal law" to protect dissenting creditor classes); *see also In re Geneva Steel Co.*, 281 F.3d 1173, 1180 n.4 (10th Cir. 2002) ("[U]nsecured creditors stand ahead of investors in the receiving line and their claims must be satisfied before any investment loss is compensated." (citations omitted)).

"Contingent Claimant Trust Interest" without fully satisfying class-8 claimants. We agree the absolute-priority rule applies, and the Plan plainly satisfies it.

The Plan proposed to pay 71% of class-8 creditors' claims with *pro rata* distributions of interest generated by the Claimant Trust and then *pro rata* distributions from liquidated Claimant Trust assets. Classes 10 and 11 received a *pro rata* share of "Contingent Claimant Trust Interests," defined as a Claimant Trust Interest vesting only when the Claimant Trustee certifies that all class-8 claimants have been paid indefeasibly in full and all disputed claims in class 8 have been resolved. Voilà: no interest junior to class 8 will receive any property until class-8 claimants are paid.

But the Advisors point to Highland Capital's testimony and briefs to suggest the Contingent Claimant Trust Interests (received by classes 10 and 11) are property in some sense because they have value. That argument is specious. Of course, the Contingent Claimant Trust Interests have some small probability of vesting in the future and, thus, has some *de minimis* present value. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-08 (1988) (holding a junior creditor's receipt of a presently valueless equity interest is receipt of property). But the absolute-priority rule has never required us to bar junior creditors from ever receiving property. By the Plan's terms, no trust property vests with class-10 or -11 claimants "unless and until" class-8 claims "have been paid indefeasibly in full." *See* 11 U.S.C. § 1129(b)(2)(B)(ii). That plainly comports with the absolute-priority rule.

C. Bankruptcy Rule 2015.3

We turn to whether the failure to comply with Bankruptcy Rule of Procedure 2015.3 bars the Plan's confirmation. The Independent Directors failed to file periodic financial reports per Federal Rule of Bankruptcy Procedure 2015.3(a) about entities "in which the [Highland Capital] estate holds a substantial or controlling interest." The Advisors claim the failure dooms the Plan's confirmation because the Plan proponent failed to comply "with the applicable provisions of this title." 11 U.S.C. § 1129(a)(2). We disagree.

Rule 2015.3 cannot be an applicable provision of Title 11 because the Federal Rules of Bankruptcy Procedure are not provisions of the Bankruptcy Code. *See Bonner v. Adams (In re Adams)*, 734 F.2d 1094, 1101 (5th Cir. 1984) ("The Bankruptcy Rules Enabling Act, 28 U.S.C. § 2075, provides that the Supreme Court may prescribe 'by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure' in bankruptcy courts."); *cf. In re Mandel*, No. 20-40026, 2021 WL 3642331, at *6 n.7 (5th Cir. Aug. 17, 2021) (per curiam) (noting "Rule 2015.3 implements section 419 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," which amended 28 U.S.C. § 2073). The Advisors' attempt to tether the rule to the bankruptcy trustee's general duties lacks any legal basis. *See* 11 U.S.C. §§ 704(a)(8), 1106(a)(1), 1107(a). The bankruptcy court, therefore, correctly overruled the Advisors' objection.

D. Factual Findings

One factual finding is in dispute, but we see no clear error. The bankruptcy court found that, despite their purported independence, the Funds are entities "owned and/or controlled by [Dondero]." The Funds ask the court to vacate the factual finding because it threatens the Funds' compliance with federal law and damages their reputations and values. According to the Funds, the characterization is unfair, as *they* are not litigious like Dondero and are completely independent from him. Highland Capital maintains Dondero has sole discretion over the Funds as their portfolio manager and through his control of the Advisors, so the finding is supported by the record.

"Clear error is a formidable standard: this court disturbs factual findings only if left with a firm and definite conviction that the bankruptcy court made a mistake." *In re Krueger*, 812 F.3d 365, 374 (5th Cir. 2016) (cleaned up). We defer to the bankruptcy court's credibility determinations. *See Randall & Blake, Inc. v. Evans (In re Canion)*, 196 F.3d 579, 587–88 (5th Cir. 1999).

Here, the bankruptcy court drew its factual finding from the testimony of Jason Post, the Advisors' chief compliance officer, and Dustin Norris, an executive vice president for the Funds and the Advisors. Post testified that the Funds have independent board members that run them. But the bankruptcy court found Post not credible because "he abruptly resigned" from Highland Capital at the same time as Dondero and is currently employed by Dondero. Norris testified that Dondero "owned and/or controlled" the Funds and Advisors. The bankruptcy court found Norris credible and relied on his testimony. The bankruptcy court also observed that none of the Funds' board members testified in the bankruptcy case and all "engaged with the Highland complex for many years." Because nothing in this record leaves us with a firm and definite conviction that the bankruptcy court made a mistake in finding that the Funds are "owned and/or controlled by [Dondero]," we leave the bankruptcy court's factual finding undisturbed.

E. The Protection Provisions

Finally, we address the legality of the Plan's protection provisions. As discussed, the Plan exculpates certain non-debtor third parties supporting the Plan from post-petition lawsuits not arising from gross negligence, bad faith, or willful or criminal misconduct. It also enjoins certain parties "from taking any actions to interfere with the implementation or consummation of the Plan." The injunction requires that, before any lawsuit is filed, the plaintiff must seek the bankruptcy court's approval of the claim as "colorable"—*i.e.*, the bankruptcy court acts as a gatekeeper. Together, the provisions screen and prevent bad-faith litigation against Highland Capital, its successors, and other bankruptcy participants that could disrupt the Plan's effectiveness.

The bankruptcy court deemed the provisions legal, necessary under the circumstances, and in the best interest of all parties. We agree, but only in part. Though the injunction and gatekeeping provisions are sound, the exculpation of certain non-debtors exceeds the bankruptcy court's authority. We reverse and vacate that limited portion of the Plan.

1. *Non-Debtor Exculpation*

We start with the scope of the non-debtor exculpation. In a Chapter 11 bankruptcy proceeding, "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." 11 U.S.C. § 524(e). Contrary to the bankruptcy court's holding, the exculpation here partly runs afoul of that statutory bar on non-debtor discharge by reaching beyond Highland Capital, the Committee, and the Independent Directors. *See Pacific Lumber*, 584 F.3d 251–53. We must reverse and strike the few unlawful parts of the Plan's exculpation provision.

The parties agree that *Pacific Lumber* controls and also that the bankruptcy court had the power to exculpate both Highland Capital and the Committee members. Appellants, however, submit the bankruptcy court improperly stretched *Pacific Lumber* to shield other non-debtors from breach-of-contract and negligence claims, in violation of § 524(e). Highland Capital counters that the exculpation provision is a commonplace Chapter 11 term, is appropriate given Dondero's litigious nature, does not implicate § 524(e), and merely provides a heightened standard of care.

To support that argument, Highland Capital highlights the distinction between a concededly unlawful release of all non-debtor liability and the

Plain's limited exculpation of non-debtor post-petition liability. *See, e.g.*, *In re PWS Holding Corp.*, 228 F.3d 224, 246–47 (3d Cir. 2000) (describing releases as "eliminating" a covered party's liability "altogether" while exculpation provisions "set[] forth the applicable standard of liability" in future litigation). According to Highland Capital, the Third and Ninth Circuits have adopted that distinction when applying § 524(e). *See Blixseth v. Credit Suisse*, 961 F.3d 1074, 1084 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021); *In re PWS Holding*, 228 F.3d at 246–47. Under those cases, narrow exculpations of post-petition liability for certain critical third-party non-debtors are lawful "appropriate" or "necessary" actions for the bankruptcy court to carry out the proceeding through its statutory authority under § 1123(b)(6) and § 105(a). *See* 11 U.S.C. § 1123(b)(6) ("[A] plan may . . . include any other appropriate provision not inconsistent with the applicable provisions of this title."); *id* § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.").

Highland Capital reads *Pacific Lumber* as "in step with the law in [those] other circuits" by allowing a limited exculpation of post-petition liability. *Cf. Blixseth*, 961 F.3d at 1084. We disagree. As the Ninth Circuit acknowledged, our court in *Pacific Lumber* arrived at "a conclusion opposite [the Ninth Circuit's]." 961 F.3d at 1085 n.7. Moreover, the Ninth Circuit expressly disavowed *Pacific Lumber*'s rationale—that an exculpation provision provides a "fresh start" to a non-debtor in violation of § 524(e)—because, in the Ninth Circuit's view, the post-petition exculpation "affects only claims arising from the bankruptcy proceedings themselves." *Ibid.* We are not persuaded, as Highland Capital contends, that the Ninth Circuit was "sloppy" and simply "misread *Pacific Lumber*." *See* O.A. Rec. 19:45–21:38.

The simple fact of the matter is that there is a circuit split concerning the effect and reach of § 524(e).[14] Our court along with the Tenth Circuit hold § 524(e) categorically bars third-party exculpations absent express authority in another provision of the Bankruptcy Code. *Pacific Lumber*, 584 F.3d at 252–53; *Landsing Diversified Props. v. First Nat'l Bank & Tr. Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990) (per curiam). By contrast, the Ninth Circuit joins the Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits in reading § 524(e) to allow varying degrees of limited third-party exculpations. *Blixseth*, 961 F.3d at 1084; *accord In re PWS Holding*, 228 F.3d at 246–47 (allowing third-party releases for "fairness, necessity to the reorganization, and specific factual findings to support these conclusions"); *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 143 (2d Cir. 2005); *In re A.H. Robins Co.*, 880 F.2d 694, 702 (4th Cir. 1989); *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002); *In re Airadigm Commc'ns., Inc.*, 519 F.3d 640, 657 (7th Cir. 2008); *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015).

Our *Pacific Lumber* decision was not blind to the countervailing view, as it twice cites the Third Circuit's contrary holding in other contexts. *See* 584 F.3d at 241, 253 (citing *In re PWS Holding*, 228 F.3d at 236–37, 246). But we rejected the parsing between limited exculpations and full releases that Highland Capital now requests. We are obviously bound to apply our own precedent. *See Hidalgo Cnty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cnty. Emergency Serv. Found.)*, 962 F.3d 838, 841 (5th Cir. 2020)

[14] Amicus's contention that failing to adopt the Ninth Circuit's holding "would generate a clear circuit split" is wrong. There already is one. *See* Petition for Writ of Certiorari, *Blixseth v. Credit Suisse*, 141 S. Ct. 1394 (No. 20-1028) (highlighting the circuits' divergent approaches to the non-debtor discharge bar under § 524(e)).

("Under our well-recognized rule of orderliness, . . . a panel of this court is bound by circuit precedent." (citation omitted)).

Under *Pacific Lumber*, § 524(e) does not permit "absolv[ing] the [non-debtor] from any negligent conduct that occurred during the course of the bankruptcy" absent another source of authority. 584 F.3d at 252–53; *see also In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995). At oral argument, Highland Capital pointed only to § 1123(b)(6) and § 105(a) as footholds. *See* O.A. Rec. 16:45–17:28. But in this circuit, § 105(a) provides no statutory basis for a non-debtor exculpation. *In re Zale*, 62 F.3d at 760 (noting "[a] § 105 injunction cannot alter another provision of the code" (citing *In re Oxford Mgmt., Inc.*, 4 F.3d 1329, 1334 (5th Cir. 1993))). And the same logic extends to § 1123(b)(6), which allows a plan to "include any other appropriate provision *not inconsistent with the applicable provisions of this title*." 11 U.S.C. § 1123(b)(6) (emphasis added).

Pacific Lumber identified two sources of authority to exculpate non-debtors. *See* 584 F.3d at 252–53. The first is to channel asbestos claims (not present here). *Id.* at 252 (citing 11 U.S.C. § 524(g)). The second is to provide a limited qualified immunity to creditors' committee members for actions within the scope of their statutory duties. *Pacific Lumber*, 584 F.3d at 253 (citing 11 U.S.C. § 1103(c)); *see In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1069 (5th Cir. 2012). And, though not before the court in *Pacific Lumber*, we have also recognized a limited qualified immunity to bankruptcy trustees unless they act with gross negligence. *In re Hilal*, 534 F.3d at 501 (citing *In re Smyth*, 207 F.3d 758, 762 (5th Cir. 2000)); *accord Baron v. Sherman (In re Ondova Ltd.)*, 914 F.3d 990, 993 (5th Cir. 2019) (per curiam). If other sources exist, Highland Capital failed to identify them. So we see no statutory authority for the full extent of the exculpation here.

The bankruptcy court read *Pacific Lumber* differently. In its view, *Pacific Lumber* created an additional ground to exculpate non-debtors: when the record demonstrates that "costs [a party] might incur defending against suits alleging such negligence are likely to swamp either [it] or the consummated reorganization." 584 F.3d at 252. We do not read the decision that way. The bankruptcy court's underlying factual findings do not alter whether it has statutory authority to exculpate a non-debtor. That is the holding of *Pacific Lumber*.

That leaves one remaining question: whether the bankruptcy court can exculpate the Independent Directors under *Pacific Lumber*. We answer in the affirmative. As the bankruptcy court's governance order clarified, nontraditional as it may be, the Independent Directors were appointed to act together as the bankruptcy trustee for Highland Capital. Like a debtor-in-possession, the Independent Directors are entitled to all the rights and powers of a trustee. *See* 11 U.S.C. § 1107(a); 7 COLLIER ON BANKRUPTCY ¶ 1101.01. It follows that the Independent Directors are entitled to the limited qualified immunity for any actions short of gross negligence. *See In re Hilal*, 534 F.3d at 501. Under this unique governance structure, the bankruptcy court legally exculpated the Independent Directors.

In sum, our precedent and § 524(e) require any exculpation in a Chapter 11 reorganization plan be limited to the debtor, the creditors' committee and its members for conduct within the scope of their duties, 11 U.S.C. § 1103(c), and the trustees within the scope of their duties, *see Baron*, 914 F.3d at 993. And so, excepting the Independent Directors and the Committee members, the exculpation of non-debtors here was unlawful.

Accordingly, the other non-debtor exculpations must be struck from the Plan. *See Pacific Lumber*, 584 F.3d at 253.[15]

As it stands, the Plan's exculpation provision extends to Highland Capital and its employees and CEO; Strand; the Reorganized Debtor and HCMLP GP LLC; the Independent Directors; the Committee and its members; the Claimant Trust, its trustee, and the members of its Oversight Board; the Litigation Sub-Trust and its trustee; professionals retained by the Highland Capital and the Committee in this case; and all "Related Persons." Consistent with § 524(e), we strike all exculpated parties from the Plan except Highland Capital, the Committee and its members, and the Independent Directors.

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[15] Highland Capital, like the bankruptcy court, claims the *res judicata* effect of the January and July 2020 orders appointing the independent directors and appointing Seery as CEO binds the court to include the protection provisions here. We lack jurisdiction to consider collateral attacks on final bankruptcy orders even when it concerns whether the court properly exercised jurisdiction or authority at the time. *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137 (2009); *In re Linn Energy, L.L.C.*, 927 F.3d 862, 866–67 (5th Cir. 2019) (quoting *Bailey*, 557 U.S. at 152). To the extent Appellants seek to roll back the protections in the bankruptcy court's January 2020 and July 2020 orders (which is not clear from their briefing), such a collateral attack is precluded.

As a result, the bankruptcy court was correct insofar as *those* orders have the effect of exculpating the Independent Directors and Seery in his executive capacities, but it was incorrect that *res judicata* mandates their inclusion in the Plan's new exculpation provision. Despite removal from the exculpation provision in the confirmation order, the Independent Directors' agents, advisors, and employees, as well as Seery in his official capacities are all exculpated to the extent provided in the January and July 2020 orders, given the orders' ongoing *res judicata* effects and our lack of jurisdiction to review those orders. But that says nothing of the effect of the Plan's exculpation provision.

2. *Injunction & Gatekeeper Provisions*

We now turn to the Plan's injunction and gatekeeper provisions. Appellants object to the bankruptcy court's injunction as vague and the gatekeeper provision as overbroad. We are unpersuaded.

First, Appellants' primary contention—that the Plan's injunction "is broad" by releasing non-debtors in violation of § 524(e)—is resolved by our striking the impermissibly exculpated parties. *See supra* Part IV.E.1.

Second, Appellants dispute the permanency of the injunction for the legally exculpated parties by enjoining conduct "on and after the Effective Date." Even assuming the issue was preserved,[16] permanency alone is no reason to alter a bankruptcy court's otherwise-lawful injunction on appeal. *See In re Zale*, 62 F.3d at 759–60 (recognizing the bankruptcy court's jurisdiction to issue an injunction in the first place allowed it to issue a permanent injunction).

Third, the Advisors argue that the injunction is "overbroad and vague" because it does not define what it means to "interfere" with the "implementation or consummation of the Plan." That is unsupported by the record. As the bankruptcy court recognized, the Plan defined what constitutes interference: (i) filing a lawsuit, (ii) enforcing judgments, (iii) enforcing security interests, (iv) asserting setoff rights, or (v) acting "in any manner" not conforming with the Plan. The injunction is not unlawfully overbroad or vague.

Finally, Appellants maintain that the gatekeeper provision impermissibly extends to unrelated claims over which the bankruptcy court

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[16] *See Roy*, 950 F.3d at 251 ("Failure adequately to brief an issue on appeal constitutes waiver of that argument." (citation omitted)).

lacks subject-matter jurisdiction. *See In re Craig's Stores of Tex., Inc.*, 266 F.3d 388, 390 (5th Cir. 2001) (noting a bankruptcy court retains jurisdiction post-confirmation only over "matters pertaining to the implementation or execution of the plan" (citations omitted)). While that may be the case, our precedent requires we leave that determination to the bankruptcy court in the first instance.

Courts have long recognized bankruptcy courts can perform a gatekeeping function. Under the "*Barton* doctrine," the bankruptcy court may require a party to "obtain leave of the bankruptcy court before initiating an action in district court when the action is against the trustee or other bankruptcy-court-appointed officer, for acts done in the actor's official capacity." *Villegas v. Schmidt*, 788 F.3d 156, 159 (5th Cir. 2015) (emphasis added) (quoting *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000)); *accord Barton v. Barbour*, 104 U.S. 126 (1881).[17] In *Villegas*, we held "that a party must continue to file with the relevant bankruptcy court for permission to proceed with a claim against the trustee." 788 F.3d at 158. Relevant here, we left to the bankruptcy court, faced with pre-approval of a claim, to determine whether it had subject matter jurisdiction over that claim in the first instance. *Id.* at 158–59; *see, e.g.*, *Carroll v. Abide*, 788 F.3d 502, 506–07 (5th Cir. 2015) (noting *Villegas* "rejected an argument that the *Barton* doctrine does not apply when the bankruptcy court lacked jurisdiction"). In other words, we need not evaluate whether the bankruptcy court would have

[17] The Advisors also maintain that Highland Capital is neither a receiver nor a trustee, so *Barton* has no application here. We disagree. Highland Capital, for all practical purposes, was a debtor in possession entitled to the rights of a trustee. *See* 7 COLLIER ON BANKRUPTCY ¶ 1101.01 ("The debtor in possession is generally vested with all of the rights and powers of a trustee as set forth in section 1106 . . . ."); *see also Carter*, 220 F.3d at 1252 n.4. (finding no distinction between bankruptcy court "approved" and bankruptcy court "appointed" officers).

jurisdiction under every conceivable claim falling under the widest interpretation of the gatekeeper provision. We leave that to the bankruptcy court in the first instance.[18]

* * *

In sum, the Plan violates § 524(e) but only insofar as it exculpates and enjoins certain non-debtors. The exculpatory order is therefore vacated as to all parties *except* Highland Capital, the Committee and its members, and the Independent Directors for conduct within the scope of their duties. We otherwise affirm the inclusion of the injunction and the gatekeeper provisions in the Plan.[19]

V. Conclusion

Highland Capital's motion to dismiss the appeal as equitably moot is DENIED. The bankruptcy court's judgment is AFFIRMED in part, REVERSED in part, and REMANDED for further proceedings consistent with this opinion.

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[18] For the same reasons, we also leave the applicability of *Barton*'s limited statutory exception to the bankruptcy and district courts in the first instance. *See* 28 U.S.C. § 959(a) (allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession "carrying on business connected with [their] property").

[19] Nothing in this opinion should be construed to hinder the bankruptcy court's power to enjoin and impose sanctions on Dondero and other entities by following the procedures to designate them vexatious litigants. *See In re Carroll*, 850 F.3d 811, 815 (5th Cir. 2017) (per curiam). But non-debtor exculpation within a reorganization plan is not a lawful means to impose vexatious litigant injunctions and sanctions.

CLERK, U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS

ENTERED

THE DATE OF ENTRY IS ON
THE COURT'S DOCKET

The following constitutes the ruling of the court and has the force and effect therein described.

Signed February 27, 2023

United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	§	Chapter 11
	§	
HIGHLAND CAPITAL MANAGEMENT, L.P.,	§	Case No. 19-34054-sgj11
	§	
Reorganized Debtor.	§	
	§	

MEMORANDUM OPINION AND ORDER ON REORGANIZED DEBTOR'S MOTION TO CONFORM PLAN [DE # 3503]

I. INTRODUCTION

This Memorandum Opinion and Order addresses a *Motion to Conform Plan* [DE # 3503] ("*Motion*") filed by Highland Capital Management, L.P. ("Highland" or the "Reorganized Debtor").[1] The *Motion* was filed in response to a ruling of the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit") in connection with an appeal of the confirmation order on

[1] The court will sometimes use the term "Debtor" when referring to Highland during the post-petition/pre-confirmation time period.

Highland's Chapter 11 plan ("Plan"). As further explained herein, the Fifth Circuit affirmed the confirmation order in all respects except the following: it determined that certain ***exculpations*** in the Plan, as to certain parties, were impermissible pursuant to section 524(e) of the Bankruptcy Code and should be stricken as to those parties. More specifically, the Fifth Circuit held that the only parties properly entitled to Plan exculpations were: the Debtor, the Official Committee of Unsecured Creditors (the "UCC") and its members, and the "Independent Directors"[2] (collectively, the "Properly Exculpated Parties"). The Fifth Circuit then remanded "to the Bankruptcy Court for further proceedings in accordance with the opinion of this Court."[3]

Accordingly, the Reorganized Debtor filed the *Motion*, proposing that the bankruptcy court approve a scaled down defined term for "Exculpated Parties" in the Plan. This, says the Reorganized Debtor, is all that the Fifth Circuit's mandate required—i.e., a narrowing of the defined universe of persons who received exculpations under the Plan.

Three sets of parties objected to the *Motion*: (a) Highland Income Fund, NexPoint Strategic Opportunities Fund, Highland Global Allocation Fund, and NexPoint Capital, Inc. (the "Funds") [DE # 3539]; (b) the Dugaboy Investment Trust ("Dugaboy")[4] [DE # 3540]; and (c) NexPoint Advisors, L.P. and Highland Capital Management Fund Advisors, L.P. (the "Advisors") [DE # 3551].[5] These objectors argue that the Fifth Circuit's ruling requires more surgery on the Plan than simply narrowing the defined term for "Exculpated Parties." The Reorganized Debtor disagreed in a Reply [DE # 3566], and the court thereafter held a hearing to allow oral argument. The court gave an oral ruling from the bench at the hearing, stating that the Reorganized Debtor's

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[2] The Independent Directors—consisting of James P. Seery, Jr., John Dubel, and Retired Bankruptcy Judge Russell Nelms—were appointed by the bankruptcy court and were comparable to "quasi-trustees."
[3] *NexPoint v. Highland Capital Management*, Case No. 21-10449 at DE # 213 (5th Cir. Sep. 12, 2022).
[4] Dugaboy is a family trust of James Dondero ("Mr. Dondero"), the co-founder and former CEO of the Debtor.
[5] It has been conceded at prior hearings that the Advisors are controlled by Mr. Dondero. The court assumes that is still the case.

proposal of simply changing the defined term in the Plan for "Exculpated Parties" would seem to properly address the Fifth Circuit's ruling and mandate, but the parties asked the court to draft a formal written Order providing its reasoning, for the parties' benefit and in case there were appeals of the court's ruling on the *Motion*. This constitutes the court's written ruling.

II. RELEVANT BACKGROUND

On October 16, 2019, Highland filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. On February 22, 2021, the bankruptcy court entered a Confirmation Order [DE # 1943] confirming the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (as Modified) [Docket No. 1808] (as subsequently modified, the "Plan"). The Confirmation Order was appealed by the Funds, the Advisors, Dugaboy, the Get Good Trust (the latter of which is another family trust of Mr. Dondero), and Mr. Dondero in his individual capacity ("Appellants") [DE ## 1957, 1966, 1970, 1972]. Appellants' appeal was certified for direct appeal to the Fifth Circuit.

On August 19, 2022, the Fifth Circuit issued an opinion (the "Initial Fifth Circuit Opinion")[6] and a judgment ("Judgment") affirming in substantial part the Confirmation Order, stating that it reversed "only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e)," and would "strike those few parties from the plan's exculpation, and affirm on all remaining grounds."[7] The Fifth Circuit remanded to the bankruptcy court "for further proceedings in accordance with the opinion of this Court."[8]

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[6] *NexPoint v. Highland Capital Management*, 2022 WL 3571094, Case No. 21-10449, slip opinion previously available at DE # 194 (5th Cir. Aug. 19, 2022). The Initial Fifth Circuit Opinion was attached to the Funds' objection to the *Motion* as an Exhibit A [DE # 3539].
[7] *Id.* at p. 2.
[8] *Id.*

On September 2, 2022, the Funds filed a short (four-and-one-half pages) motion for rehearing at the Fifth Circuit (the "Motion for Rehearing").[9] This was on the Friday before Labor Day. The Funds requested "that the Court narrowly amend the [Initial Fifth Circuit] Opinion in order to confirm the Court's holding that the impermissibly exculpated parties are similarly struck from the protections of the injunction and gatekeeper provisions of the plan (in other words, that such parties cannot constitute 'Protected Parties')." As later explained, the Plan contained distinct "Exculpation," "Injunctions," and "Gatekeeper" provisions. On September 7, 2022 (the Tuesday after Labor Day), the Fifth Circuit granted the Motion for Rehearing and, without entertaining responses or oral argument, withdrew the Initial Fifth Circuit Opinion and entered a substituted opinion (the "Final Fifth Circuit Opinion").[10] The Final Fifth Circuit Opinion ***replaced only one sentence*** that had been in the Initial Fifth Circuit Opinion:

> ***"The injunction and gatekeeper provisions are, on the other hand, perfectly lawful"***[11]
>
> with the following sentence:
>
> ***"We now turn to the Plan's injunction and gatekeeper provisions."***[12]

However, in the Final Fifth Circuit Opinion, same as the Initial Fifth Circuit Opinion, the Fifth Circuit stated that, with regard to the Confirmation Order, the panel would "reverse only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), strike those few parties from the plan's exculpation, and affirm on all remaining grounds."[13] To be clear, no

[9] DE # 3539, Exhibit C thereto.
[10] *NexPoint v. Highland Capital Management*, 48 F.4th 419, Case No. 21-10449, slip opinion at DE # 210 (5th Cir. Sep. 7, 2022). The Final Fifth Circuit Opinion was attached to the Funds' objection to the *Motion* as an Exhibit C [DE # 3539]. Most subsequent references to the Final Fifth Circuit Opinion will cite to the published version of it in the West Reporter Service, appearing at 48 F.4th 419.
[11] *See* slip opinion, at p. 27 [DE # 3539, Exhibit A thereto].
[12] *See* Final Fifth Circuit Opinion, slip opinion at p. 28 [DE # 3539, Exhibit C thereto]. 48 F.4th at 438.
[13] 48 F.4th at 424.

findings, discussion, or rulings regarding the injunction and gatekeeper provisions that were in the Initial Fifth Circuit Opinion were disturbed.

The Fifth Circuit's docket reflects that it issued its Judgment and a mandate on September 12, 2022, remanding "to the Bankruptcy Court for further proceedings in accordance with the opinion of this Court."[14]

On October 7, 2022, the Fifth Circuit denied a motion by certain Appellants for a stay of the mandate.[15]

Thereafter, on January 10 and 23, 2023, petitions for *writ of certiorari* to the United States Supreme Court were filed by the Reorganized Debtor and certain Appellants.[16] There being no stay of the Final Fifth Circuit Opinion or the mandate, this court now issues this ruling on the *Motion*.

III. JURISDICTION

The bankruptcy court has jurisdiction to rule on the *Motion* pursuant to the mandate of the Fifth Circuit issued on September 12, 2022. Furthermore, the underlying statutory authority that is applicable is 11 U.S.C. §§ 105(a) and 1142.

IV. THE PLAN PROVISIONS THAT ARE CONCEIVABLY AT ISSUE

To put the relief sought in the *Motion* and the objections thereto into proper context, a review of three sets of Plan provisions is appropriate. First, the ***exculpation provisions***. Second, the ***injunction provisions***. Third, the ***gatekeeping provisions***. These all had distinct functions;

[14] *NexPoint v. Highland Capital Management*, Case No. 21-10449 at DE # 213 (5th Cir. Sep. 12, 2022).
[15] *Id.* at DE # 222 (5th Cir. Oct. 7, 2022).
[16] *Id.* at DE ## 227 & 228 (5^{th} Cir. Jan. 10 & 23, 2023).

they were not in any way redundant. Sometimes they have been collectively referred to as the "***Protection Provisions***."

<u>Exculpations</u>. The Plan addressed Exculpation at Article IX.C thereof. The "Exculpation" provision, in pertinent part, stated as follows:

> Subject in all respects to ARTICLE XII.D of this Plan, to the maximum extent permitted by applicable law, ***no Exculpated Party will have or incur***, and each Exculpated Party is hereby exculpated from, any claim, obligation, suit, judgment, damage, demand, debt, right, Cause of Action, remedy, loss, and ***liability for conduct occurring on or after the Petition Date*** in connection with or arising out of (i) the filing and administration of the Chapter 11 Case; (ii) the negotiation and pursuit of the Disclosure Statement, the Plan, or the solicitation of votes for, or confirmation of, the Plan; (iii) the funding or consummation of the Plan (including the Plan Supplement) or any related agreements, instruments, or other documents, the solicitation of votes on the Plan, the offer, issuance, and Plan Distribution of any securities issued or to be issued pursuant to the Plan, including the Claimant Trust Interests, whether or not such Plan Distributions occur following the Effective Date; (iv) the implementation of the Plan; and (v) any negotiations, transactions, and documentation in connection with the foregoing clauses (i)-(iv); provided, however, ***the foregoing will not apply to (a) any acts or omissions of an Exculpated Party arising out of or related to acts or omissions that constitute bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct*** or (b) Strand or any Employee other than with respect to actions taken by such Entities from the date of appointment of the Independent Directors through the Effective Date. This exculpation shall be in addition to, and not in limitation of, all other releases, indemnities, exculpations, any other applicable law or rules, or any other provisions of this Plan, including ARTICLE IV.C.2, protecting such Exculpated Parties from liability. (Emphasis added.)

The Plan had a defined term for "Exculpated Parties," at Article I.B.62 that read as follows:

> "**Exculpated Parties**" means, collectively, (i) the Debtor and its successors and assigns, direct and indirect majority-owned subsidiaries, and the Managed Funds, (ii) the Employees, (iii) Strand, (iv) the Independent Directors, (v) the Committee, (vi) the members of the Committee (in their official capacities), (vii) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (viii) the CEO/CRO; and (ix) the Related Persons of each of the parties listed in (iv) through (viii); provided, however, that, for the avoidance of doubt, none of James Dondero, Mark Okada, NexPoint Advisors, L.P. (and any of its subsidiaries and managed entities), the Charitable Donor Advised Fund, L.P. (and any of its

> subsidiaries, including CLO Holdco, Ltd., and managed entities), Highland CLO Funding, Ltd. (and any of its subsidiaries, members, and managed entities), Highland Capital Management Fund Advisors, L.P. (and any of its subsidiaries and managed entities), NexBank, SSB (and any of its subsidiaries), the Hunter Mountain Investment Trust (or any trustee acting for the trust), the Dugaboy Investment Trust (or any trustee acting for the trust), or Grant Scott is included in the term "Exculpated Party."

Simply stated, the Exculpation Provisions shielded a specified list of parties from any ***negligence liability*** for ***post-petition conduct*** in connection with the Highland Chapter 11 cases. The provisions effectuated ***an absolution of liability*** for the Exculpated Parties—but, again, only for mere negligent conduct occurring on or after the Petition Date and in connection with the case. It is also notable that the Exculpation Provisions deal only with pre-Effective Date Parties (i.e., not any parties created by the terms of the Plan, such as the Litigation Trustee or Claimant Trustee).

Injunctions. The Plan addresses Injunctions at Article IX.F, in the first three paragraphs thereof. The "Injunctions" provision, in pertinent part, stated as follows:

> Upon entry of the Confirmation Order, all Enjoined Parties are and shall be permanently enjoined, on and after the Effective Date, ***from taking any actions to interfere with the implementation or consummation of the Plan***.
>
> Except as expressly provided in the Plan, the Confirmation Order, or a separate order of the Bankruptcy Court, all Enjoined Parties are and shall be permanently enjoined, on and after the Effective Date, with respect to any Claims and Equity Interests, from directly or indirectly (i) commencing, conducting, or continuing in any manner any suit, action, or other proceeding of any kind (including any proceeding in a judicial, arbitral, administrative or other forum) against or affecting ***the Debtor or the property of the Debtor***, (ii) enforcing, levying, attaching (including any prejudgment attachment), collecting, or otherwise recovering, enforcing, or attempting to recover or enforce, by any manner or means, any judgment, award, decree, or order ***against the Debtor or the property of the Debtor***, (iii) creating, perfecting, or otherwise enforcing in any manner, any security interest, lien or encumbrance of any kind ***against the Debtor or the property of the Debtor***, (iv) asserting any right of setoff, directly or indirectly, against any obligation due to the ***Debtor or against property or interests in property of the Debtor***, except to the limited extent permitted under Sections 553 and 1141 of the Bankruptcy Code, and (v) ***acting or proceeding in any manner, in any place whatsoever, that does not conform to or comply with the provisions of the Plan.***

> The injunctions set forth herein shall extend to, and apply to any act of the type set forth in any of clauses (i)-(v) of the immediately preceding paragraph against any successors of the Debtor, including, ***but not limited to, the Reorganized Debtor, the Litigation Sub-Trust, and the Claimant Trust and their respective property and interests in property***. (Emphasis added.)

The Plan had a defined term for "Enjoined Parties," at Article I.B.56 that read as follows:

> "**Enjoined Parties**" means (i) all Entities who have held, hold, or may hold Claims against or Equity Interests in the Debtor (whether or not proof of such Claims or Equity Interests has been filed and whether or not such Entities vote in favor of, against or abstain from voting on the Plan or are presumed to have accepted or deemed to have rejected the Plan), (ii) James Dondero ("Dondero"), (iii) any Entity that has appeared and/or filed any motion, objection, or other pleading in this Chapter 11 Case regardless of the capacity in which such Entity appeared and any other party in interest, (iv) any Related Entity, and (v) the Related Persons[17] of each of the foregoing.

Simply stated, the injunctions were ***not*** a release, or absolution of liability, or exculpation *per se*, but were, rather, an equitable device aimed at: (a) enforcing the discharge of the Debtor; (b) protecting the Debtor's property dealt with by the Plan; and (c) preventing interference with implementation of the Plan. It was directed to claimants, equity interest holders, those who had participated in the Chapter 11 Case (including Mr. Dondero) and parties related to them. In sum—similar to so many Chapter 11 plans that this court sees—this provision was "belts and suspenders" to the Plan discharge and was essentially a ***policing mechanism to deter actions in violations of the discharge or otherwise inconsistent with the Plan***.

Gatekeeper Provisions. The Plan set forth gatekeeper provisions in the fourth paragraph of Article IX.F, although the gatekeeper provision did not use this title. This provision was very

[17] "Related Entity" and "Related Persons" were defined terms under the Plan, but the definitions will not be set forth herein, because they are not deemed relevant to the court's analysis.

much part and parcel to the Injunctions (which explains why it is located in the same section of the Plan). The provision stated:

> Subject in all respects to ARTICLE XII.D, no Enjoined Party may commence or pursue a claim or cause of action of any kind against any Protected Party ***that arose or arises from or is related to the Chapter 11 Case, the negotiation of the Plan, the administration of the Plan or property to be distributed under the Plan, the wind down of the business of the Debtor or Reorganized Debtor, the administration of the Claimant Trust or the Litigation Sub-Trust, or the transactions in furtherance of the foregoing*** without the Bankruptcy Court (i) first determining, after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind, including, but not limited to, negligence, bad faith, criminal misconduct, willful misconduct, fraud, or gross negligence against a Protected Party and (ii) specifically authorizing such Enjoined Party to bring such claim or cause of action against any such Protected Party; provided, however, the foregoing will not apply to a claim or cause of action against Strand or against any Employee other than with respect to actions taken, respectively, by Strand or by such Employee from the date of appointment of the Independent Directors through the Effective Date. ***The Bankruptcy Court will have sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable and, only to the extent legally permissible and as provided for in ARTICLE XI, shall have jurisdiction to adjudicate the underlying colorable claim or cause of action***. (Emphasis added.)

The Plan had a defined term for "Protected Parties" as follows:

> "**Protected Parties**" means, collectively, (i) the Debtor and its successors and assigns, direct and indirect majority-owned subsidiaries, and the Managed Funds, (ii) the Employees, (iii) Strand, (iv) the Reorganized Debtor, (v) the Independent Directors, (vi) the Committee, (vii) the members of the Committee (in their official capacities), (viii) the Claimant Trust, (ix) the Claimant Trustee, (x) the Litigation Sub-Trust, (xi) the Litigation Trustee, (xii) the members of the Claimant Trust Oversight Committee (in their official capacities), (xiii) New GP LLC, (xiv) the Professionals retained by the Debtor and the Committee in the Chapter 11 Case, (xv) the CEO/CRO; and (xvi) the Related Persons of each of the parties listed in (iv) through (xv); provided, however, that, for the avoidance of doubt, none of James Dondero, Mark Okada, NexPoint Advisors, L.P. (and any of its subsidiaries and managed entities), the Charitable Donor Advised Fund, L.P. (and any of its subsidiaries, including CLO Holdco, Ltd., and managed entities), Highland CLO Funding, Ltd. (and any of its subsidiaries, members, and managed entities), NexBank, SSB (and any of its subsidiaries), Highland Capital Management Fund Advisors, L.P. (and any of its subsidiaries and managed entities), the Hunter Mountain Investment Trust (or any trustee acting for the trust), the Dugaboy

> Investment Trust (or any trustee acting for the trust), or Grant Scott is included in the term "Protected Party."

Notably, the list of "Protected Parties" was not identical to the list of "Exculpated Parties." Namely, the "Protected Parties" list included several parties that were not even in existence prior to confirmation—such as the Claimant Trustee, Claimant Trust Oversight Board, and Litigation Trustee. In any event, simply put, the Gatekeeper Provision was somewhat of a tool to deal with any future, potential lawsuits that might be deemed to run afoul of the Injunctions. It did not effectuate a release or an absolution of any liability. Rather, as the "gatekeeper" nickname implies, it simply provided that a plaintiff would have to ***ask*** the gatekeeper before bringing a claim. No one would be allowed to bring a claim against a defined universe of "Protected Parties" without first asking the bankruptcy court. The bankruptcy court would have to determine, after notice, that such claim or cause of action represents a colorable claim against a Protected Party and specifically authorize such plaintiff to bring such claim against any such Protected Party. If the bankruptcy court were to deny permission, then, presumably, such denial could be appealed.

The Confirmation Order addressed Exculpation, the Injunctions, and the Gatekeeper Provisions at length at pages 48-59.

V. THE RELIEF SOUGHT IN THE MOTION TO CONFORM PLAN

As noted earlier, in the *Motion*, the Reorganized Debtor proposes that only one change is needed to make the Plan compliant with the Fifth Circuit's ruling: narrow the defined term for "Exculpated Parties" to read as follows:

> "Exculpated Parties" means, collectively, (i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) members of the Committee (in their official capacities).

The Reorganized Debtor states that this one simple revision of this defined term "directly addresses all instances of exculpation deemed by the Fifth Circuit to violate section 524(e) of the Bankruptcy Code, and no other changes" are required to conform the Plan and Confirmation Order to the Final Fifth Circuit Opinion.[18]

The Funds' Opposition. The Funds support the revision of the defined term "Exculpated Parties," as proposed by the Reorganized Debtor, but they argue that the defined term "Protected Parties" must likewise be revised to "fully implement[ ] the mandate of the Fifth Circuit . . . ." [19] The Funds point to their Motion for Rehearing filed at the Fifth Circuit, wherein they expressed concern that "the Court's statement that the injunction and gatekeeper provisions are 'perfectly lawful,' might be argued to mean that the injunction and gatekeeper provisions – without any tailoring – are allowed to stand."[20] The Funds specifically asked the Fifth Circuit panel to revise its opinion to clarify and "to confirm the Court's holding that the impermissibly exculpated parties are similarly struck from the protections of the injunction and gatekeeper provisions of the Plan (in other words, that such parties cannot constitute 'Protected Parties'), such that the injunction and gatekeeper provisions extend only to Highland Capital, the Committee and its members, and the Independent Directors."[21] The Funds' argue that the fact that the panel granted the Motion for Rehearing and removed the "perfectly lawful" sentence (replacing it with the sentence noted above) and otherwise left the language unchanged means that the panel agreed with the Funds' interpretation of the Initial Fifth Circuit Opinion that "the parties protected by the injunction and

[18] DE # 3503, ¶ 11.
[19] DE # 3539, ¶ 3.
[20] DE # 3539, ¶ 5.
[21] DE # 3539, Exhibit B thereto, at ¶ 3.

gatekeeper provisions (the Protected Parties) must similarly be limited to the Properly Exculpated Parties – Highland, the Committee and its members, and the Independent Directors."[22] Accordingly, the Funds request that, in addition to narrowing the defined term "Exculpated Parties," the bankruptcy court order a similar narrowing of the defined term "Protected Parties" to read:

> "Protected Parties" means, collectively, (i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) members of the Committee (in their official capacities).[23]

<u>Dugaboy's Opposition.</u> Dugaboy filed a short Joinder simply adopting the arguments of the Funds.[24]

<u>The Advisors' Opposition</u>. The Advisors filed an Objection adopting the Funds' Response but requesting two additional revisions to the Plan.[25] First, the Advisors proposed fully deleting the provision in the Injunctions section (Plan, Art. IX.F., third para.) that "purports to enjoin claims against successors of the Debtor who are not entitled to limited qualified immunity under" the Final Fifth Circuit Opinion.[26] Second, the Advisors proposed "carv[ing] out from the gatekeeping provision of the injunction those suits that are expressly allowed by 28 U.S.C. § 959(a)," by "amend[ing] the fourth paragraph of Article IX.F of the Plan by excepting from the gatekeeping provisions actions that relate to the Independent Directors or Debtor 'carrying on business connected with [their] property' as provided in § 959(a)." With respect to the "carve out" request, the Advisors point to footnote 18 of the Final Fifth Circuit Opinion, which states, "[W]e also leave

[22] DE # 3539, ¶ 14.
[23] DE # 3539, ¶ 19.
[24] DE # 3540.
[25] DE # 3551.
[26] *Id.* at ¶ 6.

the applicability of *Barton*'s[27] limited statutory exception to the bankruptcy and district courts in the first instance."[28]

Highland's Reply. Highland replied to all of this by arguing that the Motion for Rehearing—and what the Funds asked for therein—is hugely significant. The Funds specifically requested, in their Motion for Rehearing, that the Fifth Circuit panel (a) limit the definition of "Protected Parties" in the same way that it did with respect to the parties entitled to exculpation, and (b) "tailor" the injunction and gatekeeper provisions, in order to confirm that the Fifth Circuit meant to narrow the parties covered by the injunctions and gatekeeper provisions of the Plan. The Fifth Circuit did none of those things when it granted the Motion for Rehearing; it simply deleted the sentence stating that the gatekeeper provisions and injunction are "perfectly lawful" and otherwise left its initial affirmance of the gatekeeper provisions and injunctions intact. Highland argues that "the Fifth Circuit . . . clarified that the Injunction was 'sound' but not 'perfectly lawful'" and that nothing in the Final Fifth Circuit Opinion supports the position that the Fifth Circuit intended to limit the Protected Parties that are protected by the Gatekeeper Provision from "harassing and frivolous litigation." Highland further argues that, since the Gatekeeper Provision is not a release, it does not implicate § 524(e), but is necessary to prevent harassment.

VI. RULING ON MOTION TO CONFORM PLAN

The court grants the request of the Reorganized Debtor, holding that the only thing that needs to be done in response to the Final Fifth Circuit Opinion and mandate is to change the defined term for "Exculpated Parties," at Art. I.B.62 of the Plan as follows:

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[27] This is, of course, a reference to *Barton v. Barbour*, 104 U.S. 126 (1881).
[28] 48 F.4th at 439 n.18 (citing 28 U.S.C. § 959(a) "(allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession 'carrying on business connected with [their] property'")).

> "'Exculpated Parties' means, collectively, (i) the Debtor, (ii) the Independent Directors, (iii) the Committee, and (iv) the members of the Committee (in their official capacities)."

In so holding, this court has scoured the Final Fifth Circuit Opinion to be clear what language survived and to discern what the Court did or did not find problematic with the Plan Protections. In that regard, this court notes the following:

On Page 429, the Fifth Circuit states:

> We then turn to the merits, conclude the Plan exculpates certain non-debtors beyond the bankruptcy court's authority, and affirm in all other respects.[29]

On Page 432, the Court states:

> We do, however, agree with Appellants that the bankruptcy court exceeded its statutory authority under § 524(e) by exculpating certain non-debtors, and so we reverse and vacate the Plan only to that extent.[30]

On Page 435, the Fifth Circuit states, before launching into a discussion of the various type of Plan Protections:

> The bankruptcy court deemed the provisions legal, necessary under the circumstances, and in the best interest of all parties. We agree, but only in part. Though the injunction and gatekeeping provisions are sound, the exculpation of certain non-debtors exceeds the bankruptcy court's authority. We reverse and vacate that limited portion of the Plan. . . . In a Chapter 11 bankruptcy proceeding, ''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.'' 11 U.S.C. § 524(e). Contrary to the bankruptcy court's holding, the exculpation here partly runs afoul of that statutory bar on non-debtor discharge by reaching beyond Highland Capital, the Committee, and the Independent Directors. *See Pacific Lumber*, 584 F.3d at 251–53. We must reverse and strike the few unlawful parts of the Plan's exculpation provision.[31]

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[29] 48 F.4th at 429.
[30] *Id.* at 432.
[31] *Id.* at 435.

On pages 437-438, in wrapping up its discussion of the Exculpation Provisions, the Fifth Circuit states:

> In sum, our precedent and § 524(e) require any exculpation in a Chapter 11 reorganization plan be limited to the debtor, the creditors' committee and its members for conduct within the scope of their duties, 11 U.S.C. § 1103(c), and the trustees within the scope of their duties, *see Baron*, 914 F.3d at 993. And so, excepting the Independent Directors and the Committee members, the exculpation of non-debtors here was unlawful. Accordingly, the other non-debtor exculpations must be struck from the Plan. *See Pacific Lumber*, 584 F.3d at 253.
>
> As it stands, the Plan's exculpation provision extends to Highland Capital and its employees and CEO; Strand; the Reorganized Debtor and HCMLP GP LLC; the Independent Directors; the Committee and its members; the Claimant Trust, its trustee, and the members of its Oversight Board; the Litigation Sub-Trust and its trustee; professionals retained by the Highland Capital and the Committee in this case; and all ''Related Persons.'' Consistent with § 524(e), we strike all exculpated parties from the Plan except Highland Capital, the Committee and its members, and the Independent Directors.[32]

On page 438, immediately after the previously quoted language, the next section of the Final Fifth Circuit Opinion has a subheading "Injunction & Gatekeeper Provisions," and then states:

> ***We now turn to the Plan's injunction and gatekeeper provisions.*** Appellants object to the bankruptcy court's injunction as vague and the gatekeeper provision as overbroad. We are unpersuaded.[33]

Note that the bolded sentence above is the only new sentence in the Final Fifth Circuit Opinion, and it replaced a previous sentence that read: "The injunction and gatekeeper provisions are on the other hand, perfectly lawful."

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[32] *Id.* at 437-38.
[33] *Id.* at 438 (emphasis added).

Finally, in the penultimate paragraph of the entire Final Fifth Circuit Opinion, the Fifth Circuit states:

> In sum, the Plan violates § 524(e), but only insofar as it exculpates and enjoins certain non-debtors. The exculpatory order is therefore vacated as to all parties except Highland Capital, the Committee and its members, and the Independent Directors for conduct within the scope of their duties. We otherwise affirm the inclusion of the injunction and the gatekeeper provisions in the Plan.

On balance, this court does not know how it could be clearer, that the Fifth Circuit was holding that the exculpations of certain parties violated section 524(e), but the other Plan Protections were "sound."[34]

Of course, this still begs the question: what might the Fifth Circuit have meant in replacing the sentence ***"The injunction and gatekeeper provisions are on the other hand, perfectly lawful"*** with the sentence "***We now turn to the Plan's injunction and gatekeeper provisions"***?[35]

It is certainly awkward for this court to attempt to be a mind-reader regarding editorial or wordsmithing decisions undertaken by the Fifth Circuit. All this court can be sure of is that the Fifth Circuit declined the Funds' request, in their Motion for Rehearing, to strike or modify the defined term "Protected Parties" (that pertains to the Gatekeeper Provision) so that it would be coterminous with the defined term "Exculpated Parties." The Fifth Circuit did not modify the Gatekeeper Provision or its applicable definition of "Protected Parties" in any way, let alone in the manner that the Funds requested. And the Fifth Circuit did not include anything in its Final Fifth Circuit Opinion to indicate that the panel agreed with the Funds' analysis.

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[34] *Id.* at 435.
[35] *Id.* at 438.

Moreover, limiting the definition of "Protected Parties" to be coterminous with the defined term "Exculpated Parties" would mean that the Gatekeeper Provision would have no effect on any conduct that occurs after the Plan Effective Date. Why? ***Because the persons included in the defined term "Exculpated Parties"—as now limited by the Fifth Circuit's ruling to include only the Debtor, the UCC, the UCC members, and Independent Directors—are all gone now.*** They all ceased to exist on the Effective Date. Additionally, the Debtor would not even need a Gatekeeper Provision for pre-Effective Date conduct because the Debtor was discharged. The Gatekeeper Provision is largely forward-looking, to prevent interference with post-Effective-Date management as they consummate the Plan, wind down the assets, and administer the Claimant Trust and the Litigation Sub-Trust. As noted, the defined term for "Protected Parties" includes several parties that did not even exist pre-confirmation such as the Claimant Trustee, Claimant Trust Oversight Board, and Litigation Trustee. It is mostly a tool to deal with any future, potential lawsuits that might be deemed to run afoul of Plan implementation. The Gatekeeper Provision did not effectuate a release or an absolution of any liability. Rather, as the "gatekeeper" nickname implies, it simply provided that a plaintiff would have to ***ask*** the gatekeeper before bringing a claim against the defined universe of "Protected Parties." If such a request is made, the bankruptcy court will determine, after notice, whether such claim or cause of action represents a colorable claim against a Protected Party and specifically authorize such plaintiff to bring such claim against any such Protected Party. If the bankruptcy court denies permission, then, presumably, such denial could be appealed.

The bankruptcy court humbly suggests that the Fifth Circuit well understood all of this. Perhaps they deleted the one sentence out of concern that there might be something in the Injunction Provisions that ran afoul of the new, narrowed defined term for "Exculpated Parties"—

for example, the catchall clause at Article IX.F(v) of the Injunction Provision. Specifically, that catchall clause, appearing after the injunctions of all sorts of conduct ***against the Debtor*** or its property, also enjoins parties from "(v) ***acting or proceeding in any manner, in any place whatsoever, that does not conform to or comply with the provisions of the Plan."*** Perhaps the Fifth Circuit thought this injunctive language was a little vague or broad, but it had fixed any problem with it, by making clear that no one was absolved from any liability except the Debtor, the UCC, the UCC members, and the Independent Directors. The Fifth Circuit had fixed any problem with the cause by ruling that the defined term "Exculpated Parties" was too broad.

But perhaps the Fifth Circuit was simply making a stylistic edit—maybe they thought the words "perfectly lawful" may have sounded a bit too rosy or glowing, with regard to gatekeeper provisions generally, and they did not want to suggest that they had blessed them for every plan in the future, no matter what the facts and circumstances were. Perhaps the word "sound" seemed more measured and case-specific than the words "perfectly lawful."

In any event, in light of the Fifth Circuit keeping intact, in its Final Fifth Circuit Opinion, the language that the "the injunction and gatekeeping provisions are sound," this court sees no need to tailor those provisions in any manner. This tailoring request was made to the Fifth Circuit in the Motion for Rehearing, and they declined.

Finally, with regard to the Advisors' request that this court delete the provision in the Injunctions section (Plan, Art. IX.F., third para.) that "purports to enjoin claims against successors of the Debtor who are not entitled to limited qualified immunity" pursuant to the Final Fifth Circuit Opinion and "carve out from the gatekeeping provision . . . those suits that are expressly allowed by 28 U.S.C. § 959(a)," the bankruptcy court declines this request. This court does not read footnote 18 of the Fifth Circuit's Final Opinion, which states, "[W]e also leave the applicability of

Barton's[36] limited statutory exception to the bankruptcy and district courts in the first instance,"[37] as necessitating any modification to the Plan whatsoever.

VII. CONCLUSION

The court grants the *Motion* and orders that one change be made to the Plan to conform it to the mandate of the Fifth Circuit: revise the definition of "Exculpated Parties" as proposed in the *Motion* and no more.

 # # # END OF MEMORANDUM OPINION AND ORDER # # #

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[36] This is, of course, a reference to *Barton v. Barbour*, 104 U.S. 126 (1881).

[37] 48 F.4th at 439 n.18 (citing 28 U.S.C. § 959(a) "(allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession 'carrying on business connected with [their] property'")).

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION**

IN RE:	§	
	§	CASE NO: 24-90052
ROBERTSHAW US HOLDING CORP., *et al.*,	§	
Debtors.	§	Jointly Administered
	§	CHAPTER 11

MEMORANDUM DECISION ON PLAN CONFIRMATION
(RE: ECF NO. 857)

Robertshaw and its affiliates ("**Robertshaw**") specialize in creating solutions used in everyday appliances. It is likely that your refrigerator, clothes washer, dryer, dishwasher, cooking range, or central heating system includes a Robertshaw product. The company employs over 5,000 people across many countries. And all of their U.S. inventory is located in facilities in Laredo and Brownsville, Texas.

Before these chapter 11 cases started, Robertshaw experienced significant business and financial challenges ranging from supply chain issues to increased material, labor, and logistics costs. At the same time, Robertshaw was also embroiled in a bitter dispute about liability management transactions with certain lenders and its equity sponsor.

Robertshaw started these chapter 11 cases in February 2024 to pursue a value maximizing sale of assets and to resolve claims asserted in prepetition lawsuits about the liability management transactions. Over the past six months, much has happened. The Court has addressed debtor-in-possession financing issues, bidding procedures for an auction for the sale of substantially all of Robertshaw's assets, approved a sale for the assets with a credit bid, and presided over an adversary proceeding involving liability management disputes. Everything has been hotly contested.

The Court now considers confirmation of the *First Amended Joint Plan of Liquidation of Robertshaw US Holding Corp. and its Affiliated Debtors Under Chapter 11 of the Bankruptcy Code* ("**Plan**"). The Plan is supported by an ad hoc group of Robertshaw's secured creditors, its equity sponsor, and the Official Committee of Unsecured Creditors ("**UCC**"). All objections have been resolved except from two objectors.

Invesco Senior Secured Management, Inc. and certain related funds ("**Invesco**") object to plan confirmation for several reasons, including a global settlement with the UCC embodied in the Plan, plan classification under Bankruptcy Code § 1122, unfair discrimination under § 1129(b)(1), and plan feasibility under § 1129(a)(11). Separately, the U.S. Trustee alleges the opt-out feature for consensual third-party releases under the Plan is improper in light of the recent U.S. Supreme Court decision in *Harrington v. Purdue Pharma, L.P.*, 144 S. Ct. 2071 (2024). For the reasons stated below, each of the objections is overruled. The Court confirms the Plan.

Jurisdiction and Venue

The Court has jurisdiction under 28 U.S.C. § 1334(b). Venue is proper in this District under 28 U.S.C. §§ 1408 and 1409. This is a core proceeding under 28 U.S.C. §§ 157(b)(2)(L). The Court has constitutional authority to enter final orders and judgments. *Stern v. Marshall*, 564 U.S. 462, 486–87 (2011).

Background

The record ("**Record** ") established to support confirmation of the Plan includes:

All documents identified on Robertshaw's Amended Witness and Exhibit List (ECF Nos. 868, 870), including:

- the Plan;
- Disclosure Statement related to the Plan;
- Settlement Term Sheet with the UCC;
- First Amended Plan Supplement;
- Declaration Alex Orchowski of Kroll Restructuring Administration LLC, including the voting and tabulation reports annexed to the declaration ("**Voting Report**");
- Declaration of Stephen Spitzer of AlixPartners (as modified on the record at the hearing);
- Declaration of Scott D. Vogel, Independent Director (as modified on the record at the hearing);
- Declaration of Neil Goldman, Independent Director (as modified on the record at the hearing); and
- Declaration of Andrew Scruton of FTI Consulting, Inc.

<u>The U.S. Trustee's Objection is Overruled</u>

The Supreme Court's recent decision in *Harrington v. Purdue Pharma* resolved a circuit-split about non-consensual third-party releases in chapter 11 plans. The Court held that the Bankruptcy Code does not "authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants." *Purdue Pharma*, 144 S. Ct. at 2088. Even before *Purdue*, Fifth Circuit case law appeared to prohibit non-consensual third-party releases. *See Feld v. Zale Corp.* (*In re Zale Corp.*), 62 F.3d 746 (5th Cir. 1995); *In re Pac. Lumber Co.*, 584 F.3d 299. So *Purdue* did not change the law in this Circuit.

The Plan does not include non-consensual third-party releases like the ones addressed in *Purdue*. It contains consensual ones. So the *Purdue* decision does not apply here. The U.S. Trustee provided comments to Robertshaw on the Plan solicitation materials before they were approved by this Court.[119] Now it objects to the consensual third-party releases on the basis of the *Purdue* decision. The Trustee wants to use the *Purdue* holding as an opportunity to advance its long-held position that consensual third-party releases in a plan should require an opt-in feature, rather than an opt-out.

To be clear, the Trustee does not object to consensual third-party releases in a chapter 11 plan, it just wants opt-in versus opt-out. The Trustee says that *Purdue* clarifies that third-party releases are between two nondebtors (but that was always the case). The Trustee also says the opt-outs are "coercive" and otherwise improper. Robertshaw, the Ad Hoc Group, One Rock, and the UCC argue the third-party releases are appropriate under the law.

The Trustee's objection is overruled for several reasons. First, the *Purdue* decision was about non-consensual third-party releases and the Supreme Court said nothing should cast doubt on consensual ones:

> As important as the question we decide today are ones we do not. ***Nothing in what we have said should be construed to call into question consensual third-party releases offered in connection with a bankruptcy reorganization plan***; those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here. *See, e.g.*, *In re Specialty Equipment Cos.*, 3 F.3d 1043, 1047

[119] Aug. 2, 2024 Tr. 123:12–19.

> (CA7 1993). ***Nor do we have occasion today to express a view on what qualifies as a consensual release*** or pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor . . . ***Confining ourselves to the question presented, we hold only that the bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants***.

Purdue Pharma, 144 S. Ct. at 2087–88 (emphasis added).

A few important points here. Nothing is construed to question consensual third-party releases offered in connection with a chapter 11 plan. There was also no occasion for the Supreme Court to express a view on what constitutes a consensual release. The Supreme Court confined its decision to the question presented. This Court will not narrow or expand the scope of the Supreme Court's holding. These words must be read literally.

Second, contrary to the Trustee's position, the consensual third-party releases in the Plan are appropriate, afforded affected parties constitutional due process, and a meaningful opportunity to opt out. There is nothing improper with an opt-out feature for consensual third-party releases in a chapter 11 plan. *See, e.g.*, *In re Arsenal Intermediate Holdings, L.L.C.*, No. 23-10097 (CTG), 2023 WL 2655592, at *6–8 (Bankr. D. Del. Mar. 27, 2023).[120] And what constitutes consent, including opt-out features and deemed consent for not opting out, has long been settled in this District. *See, e.g.*, *Cole v. Nabors Corp. Servs., Inc.* (*In re CJ Holding Co.*), 597 B.R. 597, 608–09 (S.D. Tex. 2019). Hundreds of chapter 11 cases have been confirmed in this District with consensual third-party releases with an opt-out. And, again, *Purdue* did not change the law in this Circuit.

The third-party releases in the Plan satisfy applicable law and the Procedures for Complex Cases in the Southern District of Texas. Parties in interest were provided detailed notice about the Plan, the deadline to object to plan confirmation, the voting deadline, and the opportunity to opt out of the third-party releases. The Disclosure Statement included a detailed description about the third-

[120] The U.S. Supreme Court and the Fifth Circuit have also approved opt-outs in non-bankruptcy cases like class actions as providing consent. *See, e.g.*, *Phillips Petroleum Co. v. Irl Shutts*, 472 U.S. 797, 811–12 (1985) (approving opt-out); *Seacor Holdings, Inc. v. Mason, (In re Deepwater Horizon)*, 819 F.3d 190 (5th Cir. 2016) (same).

party releases and the opt-out.[121] The Affidavit of Service dated July 26, 2024, also shows ballots were sent to holders of Claims in voting classes 5, 6a, 6b, 6c, 6d, 6e, 6f, and 6g.[122] All ballots provided claimants an opportunity to opt out. Non-voting parties in Classes 1, 2, 3, 4, 7, 8, 9, and 10 received a Notice of Non-Voting Status that offered a chance to opt out too.[123] The ballots and the Notice of Non-Voting Status allowed parties to carefully review and consider the terms of the third-party release and the consequences of electing not to opt-out. Each of the ballots advises in bold, that:

> **If you submit your Ballot without this box checked, or if you do not submit your Ballot by the Voting Deadline, you will be deemed to consent to the releases contained in Article X.C of the Plan to the fullest extent permitted by applicable law.**[124]

Robertshaw also caused the third-party release language to be published in the Wall Street Journal.[125] The Voting Report shows that over 100 creditors opted out of the third-party releases.[126] Based on the Record, the third-party release language is specific enough to put releasing parties on notice of the types of claims released. And that the opt-out worked. There is no evidence in the Record of coercion or confusion alleged by the Trustee.

The third-party releases are also narrowly tailored to this case. They consensually release parties from claims and causes of action based on or relating to, among other things, Robertshaw and the bankruptcy estates, Robertshaw's capital structure, the chapter 11 cases, the purchase, sale, or rescission of the purchase or sale of any asset or security of Robertshaw, the May Transactions, the December Transactions, the SPCA and related agreements (including intercreditor agreements), Robertshaw's in or out-of-court restructuring and recapitalization efforts, the Sale Order, the Disclosure Statement, the DIP Order, the DIP documents, and the Plan and related agreements.[127] There is also an important carve-out for Released Claims unrelated to Robertshaw, claims preserved by the Plan or related documents, or claims arising from an act or omission judicially determined by a final order to have constituted actual fraud, gross negligence,

[121] Disclosure Statement at ii, v, 5, 58, 61.
[122] Aff. Service, ECF No. 812.
[123] *See* Aff. Service at 136–39.
[124] *See* Aff. Service at 26, 41, 55, 69, 83, 97, 111, 125.
[125] *See* Certificate Publication, ECF No. 728.
[126] *See* Orchowski Decl. ¶ 12, ECF No. 868-21.
[127] Plan at 65.

willful misconduct, or criminal conduct (other than with respect to or relating to the adversary actions).[128]

Furthermore, based on the unrefuted Declaration of Stephen Spitzer, the third-party release "is an integral part of the Plan and was a condition of the settlements set forth therein."[129] And the releases were a "core" consideration "among the parties to the Restructuring Support Agreement, instrumental in the development of the Plan, and crucial in facilitating and gaining support for the Plan and the chapter 11 Cases by the Released Parties, including the concessions resulting in the elimination of over $640 million in funded debt obligations."[130] There is no evidence in the Record to refute these findings. Thus, the third-party releases are consensual and narrowly tailored. The UCC—an active participant in these cases with a fiduciary duty to all unsecured creditors—doesn't oppose the opt-out for the releases either. The U.S. Trustee's objection is overruled.[131]

<u>Conclusion</u>

For the reasons stated above, the Plan, including the Committee Settlement, satisfies all requirements under the Bankruptcy Code and applicable law. The Plan preserves and creates value for all stakeholders, including trade creditors on a go-forward basis. It also allows a company with a proud American history of operating for over 100 years to emerge from chapter 11 and saves jobs. The Court confirms the Plan. The Court will issue a separate confirmation order incorporating this Memorandum Decision.

Signed: August 16, 2024

Christopher M. Lopez

Christopher Lopez
United States Bankruptcy Judge

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[128] *Id.*
[129] Spitzer Decl. ¶ 60.
[130] Spitzer Decl. ¶ 60; *see also* Vogel Decl. ¶ 30.
[131] The U.S. Trustee and Invesco stated at the confirmation hearing that certain language in the Plan could be construed to still bind a third-party subject to the releases even if they opted out. To avoid any such confusion, the Confirmation Order will state that any party who opted out of the third-party releases in the Plan is not bound by such releases.

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE**

In re: SMALLHOLD, INC., Debtor.	Chapter 11 Case No. 24-10267 (CTG) **Related Docket No. 250**

<u>MEMORANDUM OPINION</u>

In its recent decision in *Purdue Pharma*, the Supreme Court held that the Bankruptcy Code does not authorize bankruptcy courts to confirm a plan of reorganization that provides for the release of a creditor's claim against a non-debtor.[1] That holding, however, was expressly limited to *nonconsensual* third-party releases. The Court made clear that "[n]othing in what we have said should be construed to call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan[.]"[2]

The law in this jurisdiction before *Purdue Pharma* permitted nonconsensual third-party releases in exceptional cases.[3] But at least in this Court, such cases truly were exceptional.[4] *Consensual* releases, on the other hand, are commonplace. The

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[1] *See Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 2071 (2024).

[2] *Id.* at 2087 (emphasis in original).

[3] *See generally In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000).

[4] Indeed, the 24 years between *Continental* and *Purdue Pharma*, the undersigned judge is aware of only five cases in the District of Delaware in which courts confirmed plans of reorganization providing for nonconsensual third-party releases. *See In re Millennium Lab Holdings II, LLC.,* Doc. No. 195 (Bankr. D. Del. Dec. 14, 2015); *TK Holdings Inc.*, No. 17-11375, D.I. 2109-3 (Bankr. D. Del. Feb. 20, 2018); *In re Weinstein Company Holdings*, No. 18-10601, D.I. 3203 (Bankr. D. Del. Jan. 26, 2021); *In re Mallinckrodt PLC*, 639 B.R. 837, 866

judges of this Court, however, have long expressed differing views on what constitutes consent. Some opinions have adopted a "contract" model, concluding that a finding of consent required an affirmative indication that the creditor consented to the release.[5] To comply with this view, a creditor was typically required affirmatively to check a box on its ballot indicating that it intended to "opt in" to the third-party release. Others have taken the opposite view, concluding that so long as the creditor was clearly and conspicuously informed that the failure to "opt out" would operate a release of third-party claims, such a release would be effective against any creditor that did not check a box to "opt out" of the third-party release.[6]

The undersigned judge had previously approved of "opt out" third-party releases.[7] But the reason this Court reached that conclusion can be described as a "default" theory. Under *Continental*, whether a *nonconsensual* third-party release could or could not be imposed on an objecting creditor depended on the evidence the debtor brought forward at the confirmation hearing. The *possibility* that a plan might be confirmed that provided a nonconsensual release was sufficient to impose on the creditor the duty to speak up if it objected to what the debtor was proposing. In this sense, the third-party release was a contestable plan provision like any other –

(Bankr. D. Del. 2022); *In re Boy Scouts of America and Delaware BSA, LLC,* 642 B.R. 504, 588 (Bankr. D. Del 2022).

[5] *In re Washington Mutual, Inc.,* 442 B.R. 314, 352 (Bankr. D. Del. 2011); *In re Emerge Energy Services, L.P.*, No. 19-11563 (KBO), 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019).

[6] *See In re DBSD North America, Inc.*, 419 B.R. 179 (Bankr. S.D.N.Y. 2009).

[7] *See In re Arsenal Intermediate Holdings, LLC*, No. 23-10097, 2023 WL 2655592 (Bankr. D. Del. Mar. 27, 2023).

including one that set the cure amount for a thousand assumed contracts at $0. Creditors who are validly served with a plan and who take issue with the proposed cure amount or the third-party release are required to speak up. And a creditor who does not speak up can be "defaulted." Once the plan is confirmed, the $0 cure amount will be binding on the creditor. And so would (at least before *Purdue Pharma*) the third-party release. The failure to opt out, and thus to allow entry of the third-party release to be entered by default, could be described as the creditor's "consent" to that third-party release.

This Court thus viewed the practice of providing a ballot with a box affording the creditor the opportunity to "opt out" to be a matter of administrative convenience. In the absence of this kind of ballot, such a creditor could be required to file an objection to the plan on the ground that the high standard established by *Continental* for nonconsensual third-party releases was not met, and that the plan was therefore unconfirmable. If the creditor filed such an objection, the debtor would carve that creditor out of the third-party release, which would then be enforceable only against those creditors who did not raise an objection – those who "consented" to it. The practice of including a box on creditors' ballots to check if they objected to the release was just an administrative shortcut to relieve those creditors of the burden of having to file a formal plan objection.

But that analysis is no longer viable after *Purdue Pharma*. Under established principles, courts in civil litigation will enter default judgments against defendants only after satisfying themselves that the relief the plaintiff seeks is relief that is at least potentially available to the plaintiff in litigation. Where it is clear that the complaint seeks relief that is unavailable as a matter of law, a court should not enter a default judgment under the ordinary application of Civil Rule 55.

After *Purdue Pharma*, a third-party release is no longer an ordinary plan provision that can properly be entered by "default" in the absence of an objection. It is unlike the listed cure amount where one can properly impose on a creditor the duty to object, and in the absence of such an objection bind the creditor to the judgment. The *nonconsensual* third-party release is now *per se* unlawful. As such, it is not the kind of provision that would be imposed on a creditor on account of that creditor's default.

And in the absence of the default theory of "consent," no other justification for treating the failure to "opt out" as "consent" to the release can withstand analytic scrutiny. Some of the decisions that have authorized the opt-out approach but have not relied on the "default" principle have instead suggested that a creditor's consent can be inferred from the fact that the creditor received clear and conspicuous notice of the release and was given the opportunity to opt out of it. But aside from a context in which a default may properly be entered, there is no other context in which *that* kind of consent provides a lawful basis for separating someone from their own legal rights. That theory of consent simply proves too much. It would authorize courts to impose on creditors "consensual" obligations to which no court would subject a party in the absence of an affirmative expression of consent. Before such an obligation may be imposed, the law would typically require the creditor to provide some affirmative indication that the creditor agrees to the terms at issue.

Imagine that Party A, after hitting Party B's car in the parking garage, wrote a letter to Party B, stating that unless Party B responded to the letter in 10 days, Party B would be obligated to release any claim she might have against Party A in exchange for a payment of $100. No court would treat Party B's failure to respond as "consent" to those terms in a way that bound Party B to release her claim against Party A. Treating the failure to check a box on a ballot in bankruptcy is no different. Consider, for example, a plan of reorganization that provided that each creditor who failed to check an "opt out" box on a ballot was required to make a $100 contribution to the college education fund for the children of the CEO of the debtor.[8] Just as in the case of Party A's letter to Party B, no court would find that in these circumstances, a creditor that never returned a ballot could properly be subject to a legally enforceable obligation to make the $100 contribution. But none of the cases that authorizes the opt-out third-party release provides any limiting principle that would distinguish the third-party release from the college education fund plan. And after *Purdue Pharma*, there is none.

The plan now before the Court involves some interesting wrinkles. It does not purport to impose a release on a creditor who received a ballot and failed to return it. There are only two categories of creditors who would be bound. First are creditors

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[8] Because this Memorandum Opinion will make repeated reference to such a plan, this hypothetical plan is referred to as the "college education fund plan."

who did not receive a ballot at all because they are being paid in full under the plan and are thus deemed to accept it without having to vote. The Court appreciates that *Purdue Pharma* expressly left open the question whether creditors whose claims are satisfied in full under a plan may be subject to a release. But even if such a release may be imposed in an appropriate case, the argument for such a release is not sufficiently developed by the parties here to warrant its imposition.

The second category of creditors that are deemed to grant the release are those who voted in favor of or against the plan and did not opt out. These creditors were clearly and conspicuously informed that voting on the plan (whether the creditor voted to accept or reject it) would constitute a release *unless* the creditor opted out. These creditors were provided a simple opt-out tool on the ballot. The Court is satisfied that under these circumstances, the affirmative act of voting, coupled with clear and conspicuous disclosure and instructions about the consequences of the vote and a simple mechanism for opting out, is a sufficient expression of consent to bind the creditor to the release under ordinary contract principles. So these third-party releases, unlike those that the plan purports to impose on creditors who were paid in full and thus did not vote and never made any affirmative expression of consent, may properly be enforced.

This Court is sympathetic to the *policy* argument in favor of the broader form of opt-out releases. They help achieve the objective of finality and closure, which is an important bankruptcy value. But one could say the same thing about the nonconsensual third-party release as applied to the rare case in which it is critical to the debtor's reorganization. *Purdue Pharma*, however, holds that the text of the Bankruptcy Code does not authorize the nonconsensual third-party release. And after that decision, there does not appear to be a principled basis for authorizing "opt out" third-party releases in cases like this one, even if such releases might be supported by strong policy arguments.

Even so, it bears note that the sky is not falling. There are important ways in which the bankruptcy policies in favor of finality can still be achieved after *Purdue Pharma*. That decision does not affect the practice of exculpation of estate fiduciaries (which is expressly authorized by Third Circuit precedent) or prevent a debtor in appropriate circumstances from releasing estate causes of action, which under Third Circuit law would eliminate veil-piercing liability.[9] The narrower form of opt-out plan, like the debtor provided here for general unsecured creditors, is also permissible. And this Court does not foreclose the possibility (offered in a recent article) that a different outcome on the opt-out question might be appropriate in a case in which the plan process itself builds in the protections of Rule 23(b)(3), under which a named representative is authorized to act on behalf of a class, subject to the rights of unnamed members to receive notice and opt out. For purposes of today's ruling, however, the Court does conclude that after *Purdue Pharma*, in a case like the one now before the Court, a creditor cannot be deemed to consent to a third-party release without some affirmative expression of the creditor's consent.

[9] *See In re Emoral, Inc.*, 740 F.3d 875 (3d Cir. 2014).

Factual and Procedural Background

Smallhold is a Brooklyn, New York-based specialty mushroom farming company.[10] Using patented technology, Smallhold's indoor mushroom farms produce ecologically sustainable organically grown mushrooms in specialty varieties. The company's founders started the business in 2017 with, according to the first-day declaration, "a mission to provide an ecologically sustainable product while building direct connections with mycophiles, artists, farmers, ranchers, and others looking to celebrate fungi, build soil fertility, and grow their own food and plants."[11] Its products, including a mushroom pesto, are available in over 500 locations across ten states.[12] The debtor's founders sold their shares to Monomyth, which had been a minority investor, in February 2024.[13]

Smallhold filed for bankruptcy, under subchapter V of chapter 11, later that month. The debtor concluded that it had grown its operations (which included mushroom farms in Brooklyn, New York; Austin, Texas; and Los Angeles, California) faster than customer demand would support. Over the course of its bankruptcy case, the debtor rejected several leases and closed a number of its farms.[14] Monomyth

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[10] Smallhold, Inc. is referred to as "Smallhold."

[11] D.I. 8 at 2. The Court relies on the first-day declaration in this context simply for background. None of the facts that bear on the issues decided in this Memorandum Opinion is contested by the parties.

[12] *Id.*

[13] *Id.* at 4. Monomyth, LLC is referred to as "Monomyth." Monomyth, which also provided a DIP loan to the debtor during this bankruptcy case, *see* D.I. 95, 129, is also referred to at times as the "DIP lender."

[14] D.I. 78, 138.

sought to retain its equity interest in the debtor. The debtor, however, received a competing offer from another entity that expressed interest in acquiring the debtor out of bankruptcy. The debtor then received an improved proposal from Monomyth.[15] After extensive negotiations, which included the debtor's independent directors and the subchapter V trustee, the debtor ultimately proposed a third amended plan of reorganization that reflected the terms of its agreement with Monomyth. Save for the question of the third-party releases, all parties agree that the third amended plan is otherwise confirmable under § 1191(b) of the Bankruptcy Code, as the debtor will be contributing all of its projected disposable income for a five-year period towards the repayment of creditors.

Accordingly, the only contested issue at the August 22, 2024 confirmation hearing was the question of the plan's third-party releases. To that end, at the time the debtor filed its amended plan on June 3, 2024 (more than three weeks before the Supreme Court's *Purdue Pharma* decision), the debtor filed a certificate of counsel, which represented that the debtor, "in consultation with the Office of the United States Trustee … [has] prepared a proposed form of order [governing the plan solicitation process]."[16] The certificate of counsel expressly stated that the Office of the U.S. Trustee did not object to the debtor's proposed solicitation order.[17]

[15] That entity Kapital Partners Holding, LLC, along with its affiliate, Kapital I, LLC.

[16] D.I. 181 at 2.

[17] *Id.*

That proposed solicitation order attached a form of notice of the confirmation hearing that would be sent to all creditors. That notice clearly and conspicuously disclosed (in bold print) that: "all persons … who voted to accept this Plan or who are presumed to have voted to accept this plan and [all persons] who voted to reject this Plan but did not affirmatively mark the box on the ballot to opt out of granting the releases provided under this Plan … shall … forever release … the Released Parties of … all … causes of action … based upon any … act, omission[,] occurrence, transaction or other activity … arising … prior to the Effective Date … relating to …. the Debtor [or] the Debtor's prepetition operations."[18] The notice goes on to explain that released parties include, among others, "representatives" of the debtor (which term was originally defined to include all present and former directors and officers – although it was explained to the Court during the argument that through negotiations with the DIP lender, former officers and directors of the debtor were carved out of that definition), as well as the DIP lender and its "representatives."[19]

The proposed order also contained forms of ballot for creditors in each of the two classes. The ballots to be sent to creditors in Class 1 (a class that included only one creditor — the DIP lender) indicated that "[p]ursuant to the Plan, if you return a Ballot and vote to ACCEPT the Plan, you are automatically deemed to have accepted

[18] D.I. 181-1 at 14 of 34. Describing the disclosure as "clear" may be too charitable. As is customary, the release language is written in legalese that would not be comprehensible to a layperson. It is set out in full in Appendix A to this Memorandum Opinion.

[19] *Id.* at 14-15 of 34. The term "representative" is defined in § 9.103 of the Plan. *See* D.I. 265-1 at 38.

the Releases in Section 6.11 of the Plan."[20] Those sent to the holders in Class 2 (general unsecured creditors) provided the creditors with the option to "opt out" of the release regardless of whether the creditor voted in favor of or against the plan.[21] Importantly, nothing in this solicitation process imposed a third-party release on a class 2 creditor who never returned a ballot. Priority creditors whose claims would be paid in full, and equity holders whose interests were unimpaired, would receive a clear notice of the third-party release. While those parties could of course object to confirmation on the ground that the release was improper, the order did not contain even a form by which these parties could opt out of the releases.[22]

Based on the representation in the certificate of counsel that the solicitation procedures were fully consensual, the Court entered the order in the form proposed.[23] Between the time that order was entered and the confirmation hearing, the Supreme Court issued its decision in *Purdue Pharma*, which held that the Bankruptcy Code does not authorize bankruptcy courts to confirm plans that provide for nonconsensual third-party releases. On August 14, 2024 (approximately six weeks after the Supreme Court decision in *Purdue Pharma*), the U.S. Trustee objected to confirmation of the plan on the ground that it provides for third-party releases based on the opt-out mechanic approved in the solicitation order, which is to say that

[20] D.I. 181-1 at 22 of 34 (capitalization in original).

[21] *Id.* at 30-31 of 34.

[22] *Id.* at 11-16 of 34; *see also id.* at 18-19 of 34 (notice provided to equity holders).

[23] D.I. 182.

creditors grant releases "even where a so-called 'Releasing Party' has not affirmatively agreed to them."[24]

The confirmation hearing took place on August 22, 2024. At the hearing, the U.S. Trustee raised two issues. *First*, the U.S. Trustee argued that the opt-out mechanism was improper, because the granting of a third-party release should require the releasing party affirmatively to express its consent to the release.[25] *Second*, with respect to class 1, the U.S. Trustee argued that it is improper to provide that a creditor that votes in favor of a plan should automatically be deemed to consent to the third-party release.[26]

Factually, there are two categories of creditors as to whom the validity of their releases are at issue.

- There are the creditors whose claims would be paid in full and equity holders who were unimpaired and thus presumed to accept. Neither of these groups were provided a ballot; and
- Those creditors in class 2 (general unsecured creditors) who voted in favor of or against the plan but did not check the box indicating that they intended to opt-out of the third-party release.

The record is perhaps more ambiguous about a third category – the DIP lender in class 1. The record indicates that the DIP lender, as the only creditor in class 1,

[24] D.I. 236 at 2.

[25] Aug. 22, 2024 Hr'g Tr. at 34.

[26] *Id.* at 38.

was thus the only creditor that received the form of ballot indicating that a vote in favor of the plan *necessarily* operated to grant the third-party release, without providing an opportunity to opt out. During the August 22, 2024 hearing, however, it was represented to the Court that the DIP lender at first did not vote on the plan. But after the debtor agreed to remove its former officers and directors from the list of released parties, the DIP lender apparently changed its position and agreed to cast its vote to support the plan (and, it appears, to grant the release to the remaining released parties).[27] So while the U.S. Trustee did argue that the plan improperly coerced class 1 creditors who wanted to vote in favor of the plan to grant a third-party release, the record suggests that the only creditor that was a member of that class itself negotiated an arrangement with the debtor that was acceptable to it.

It also bears note that as to the class of general unsecured creditors (class 2) what the debtor proposes is much more modest than the paradigmatic question posed by a typical "opt-out" plan – treating a creditor whose claim is impaired under the plan as "consenting" to the release when that creditor may have simply thrown away its ballot. Here, the debtor does not propose to treat unsecured creditors who did not vote as granting the release. Rather, in the class of unsecured creditors (class 2), the release applies only to those creditors who voted in favor of or against the plan but did not check the box to opt out of the release. The release would also apply, however, to equity holders (who are unimpaired, in this subchapter V case, on account of the

[27] *Id.* at 29. *See also* Exs. S6 & S7 (balloting reports showing DIP lender switching vote from not voting to voting in favor).

debtor's committing its projected disposable income for the plan period toward the repayment of its creditors) and priority creditors whose claims were entitled to be paid in full under the plan. Both groups were deemed to accept the plan, and thus neither group was solicited to vote.

At the confirmation hearing, after the evidence was submitted and the Court heard argument, the Court asked the parties whether it might be possible to enter an order that confirmed the plan (thus allowing the debtor to emerge from bankruptcy) while reserving the question of the third-party release.[28] Both the debtor and the U.S. Trustee agreed that doing so would be permissible and appropriate.[29] The debtor thereafter filed a certificate of counsel indicating that the parties had agreed to a form of order that so provided.[30] The Court entered that form of confirmation order, which provided that the Court would separately address the effectiveness of the third-party releases set forth in § 6.10 of the Plan.[31] This Memorandum Opinion is intended to address those remaining issues.

Jurisdiction

The issue now before the Court is one that arises under the Bankruptcy Code and is therefore within the district court's "arising under" jurisdiction pursuant to 28 U.S.C. § 1334(b). That jurisdiction was referred to this Court under 28 U.S.C. § 157(a) and the district court's standing order of reference dated February

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[28] Aug. 22, 2024 Hr'g Tr. at 44.

[29] *Id.* at 44-45.

[30] D.I. 264.

[31] D.I. 265 ¶ 31.

29, 2012. As part of the plan process, this is a core matter under 28 U.S.C. § 157(b)(2)(L) and (O).

Analysis

I. The U.S. Trustee's objection to the release deemed granted by unimpaired creditors and equity holders and class 2 creditors is properly preserved and presented; the objection to the form of ballot provided to class 1 creditors is not.

The U.S. Trustee objects to three categories of third-party releases provided for in the debtor's plan: (1) the releases deemed granted by unimpaired creditors and equity holders; (2) the releases deemed granted by class 2 creditors who did not "opt out"; and (3) the release deemed granted by class 1 creditors (the only one of which appears to be the DIP lender), who would have been deemed to grant the release on account of voting for the plan, without being given the opportunity to opt out.

The first question that ought to be considered is whether the U.S. Trustee should be permitted to object to the opt out mechanism provided for here (as to any of these three categories) after it had expressly consented to the entry of the solicitation order that set forth that mechanism. An argument can certainly be made that the solicitation order, while an interlocutory order, should remain binding under the "law of the case" doctrine.

In engaging that question, there is one point that the Court should clarify at the outset. There are certainly occasions when parties object to release language at the stage of a bankruptcy case when a debtor seeks approval of a disclosure statement and solicitation procedures, and courts overrule those objections on the ground that those are matters that are more appropriately raised as confirmation issues. In

American Capital Equipment, the Third Circuit explained that while "[o]rdinarily, confirmation issues are reserved for the confirmation hearing," in circumstances in which "there is a defect that makes a plan inherently or patently unconfirmable, the Court may consider and resolve that issue at the disclosure statement stage before requiring the parties to proceed with solicitation of acceptances and rejections and a contested confirmation hearing."[32]

That means that in circumstances in which a release is obviously overbroad or unjustified, a court *could* take up the issue at the disclosure statement stage. But (particularly before *Purdue Pharma*) if a Court believed that it was possible that the evidence introduced at the confirmation hearing might inform the question of the release's propriety, a court could also defer consideration of the issue until confirmation.

In this Court's view, however, the *substance* of the release is different from the *procedure* the debtor proposes to use to solicit creditors. The reason debtors file motions for courts to approve their solicitation procedures is so that, before the estate incurs the expense of distributing the disclosure statement and plan ballot to creditors, all parties in interest have a chance to weigh in on the propriety of the proposed procedures, and the Court can resolve any dispute about them. Once a court has considered the motion and decided that the procedures are appropriate, that decision should not generally be subject to a subsequent challenge. That is the work

[32] *In re American Capital Equipment, LLC*, 688 F.3d 145, 153-154 (3d Cir. 2012) (internal quotation and citations omitted).

performed by the law-of-the-case doctrine, which "expresses the practice of courts generally to refuse to reopen what has been decided."[33]

That is not to say that a court *could not*, after approving solicitation procedures, decline to confirm a plan on the ground that the procedures were improper. A solicitation order, which is entered as an intermediate step in the plan confirmation process, is an interlocutory one. And courts always have the authority to reconsider their interlocutory orders if circumstances warrant such reconsideration.[34] But the point of the law-of-the-case doctrine is that unless there is a reason to do so, things that have been decided should not later be undecided.

The law has long recognized an exception to that doctrine, as applied to interlocutory rulings, in circumstances in which "controlling authority has since made a contrary decision of law applicable to such issues."[35] And at least as applied to the class 2 creditors and those creditors and equity holders who were never provided a ballot, the Court is satisfied that the *Purdue Pharma* decision is sufficient subsequent "controlling authority" to warrant reconsideration of the solicitation order. In view of this Court's *Arsenal* decision, there would not have been much point to objecting to the solicitation procedures on the ground that they permitted opt-out

[33] *Messenger v. Anderson*, 225 U.S. 436, 444 (1912) (Holmes, J.). Note, however, that it could at least be argued that because the solicitation order was the result of the parties' stipulation, rather than a matter that the Court actually decided, that the law of the case doctrine should not be deemed applicable. *See Whitehouse v. LaRoche*, 277 F.3d 568, 577-578 n.9 (1st Cir. 2002).

[34] *See United States v. Jerry,* 487 F.2d 600, 604 (3d Cir. 1973); *John Simmons Co. v. Grier Bros. Co.*, 258 U.S. 82, 90-91 (1922).

[35] *White v. Murtha*, 377 F.2d 428, 432 (5th Cir. 1967).

releases. So, to the extent the U.S. Trustee seeks to argue that *Purdue Pharma* requires a reconsideration of *Arsenal*, the law-of-the-case doctrine should not stand as an obstacle to making that argument.

The Court has a different reaction, however, to the U.S. Trustee's complaint about the form of ballot provided to class 1 creditors. The argument the U.S. Trustee makes there is that it is improperly coercive to *require* a creditor, in order to be permitted to vote in favor of a plan, to grant a third-party release. The Court views that argument as a serious one. In addition to (and perhaps more problematic than) the issue of "coercion" is the concern that such a practice discourages creditors from voting and may distort the voting process, which is intended to provide a valuable signal about the extent of creditor support, within each voting class, for the plan's treatment of creditors' allowed claims. None of those points, however, has been materially changed by the *Purdue Pharma* decision. And the issue may well be beside the point here, where the only creditor that received this form of ballot was the DIP lender, which has participated actively in the bankruptcy case and expressly negotiated a form of appropriate release. But to the extent the U.S. Trustee would otherwise be permitted to challenge the plan on the basis of the treatment of the release being given by the DIP lender, its failure to raise this issue in connection with the solicitation motion bars it from raising the same issue now.

II. After *Purdue Pharma*, a creditor granting a third-party release typically must affirmatively evidence its consent to the release.

On the central question presented, the Court concludes that its decision in *Arsenal* does not survive *Purdue Pharma*. The rationale of *Arsenal* was that creditors that did not object to or opt out of a third-party release could essentially be "defaulted," with the release being imposed on them, despite their silence, on that basis. After *Purdue Pharma*, however, that relief is no longer appropriate under the ordinary principles that govern when a default may be entered. Instead, affirmative consent is required. While a number of courts have reached a contrary conclusion even after *Purdue Pharma*, this Court does not find their reasoning persuasive. Without addressing the limits on courts' authority to impose a default or providing a basis to distinguish the third-party release from the college education fund plan, the rationales of these decisions provide no limiting principle on what could be accomplished by what they describe as "consent."

Applying these principles to this case, the unimpaired equity holders and creditors whose claims will be paid in full and thus were not given the opportunity to vote cannot be said to have consented to the releases. *Purdue Pharma* left open the question whether in an appropriate case a *nonconsensual* release may be imposed on creditors whose claims are satisfied in full under a plan. On the undeveloped record here, however, the Court will not engage that question in this case. These parties therefore cannot be said to have granted a release.

The class 2 creditors who voted on the plan (whether they voted for or against), however, have taken a sufficient affirmative step to be deemed to consent to the third-party releases. These creditors were clearly informed and on notice of the right to opt-out of the releases before casting their votes. And because the ballot provided a simple mechanism by which these creditors could opt out, there is no risk of coercion or distortion of the plan voting process. Finally, the Court emphasizes that it is leaving open how it might decide a different case — one in which the plan process builds in the protections of the class action mechanism under Rule 23(b)(3), where an "opt-out" mechanism is deemed appropriate.

A. As a general proposition, creditors must affirmatively express consent to the release in order to be bound by it.

The question of a bankruptcy court's authority to grant a *nonconsensual* third-party release is one on which courts were divided for many years before the Supreme Court's recent decision in *Purdue Pharma.* The Court is not aware, however, of any court that has found that a creditor cannot *consensually* release a claim against a third-party under a debtor's plan of reorganization. And in holding that bankruptcy courts may not grant a nonconsensual third-party release, the Supreme Court's decision in *Purdue Pharma* went out of it its way to emphasize that "[n]othing in what we have said should be construed to call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan[.]"[36]

That statement, however, raises a different question, and one that has also divided bankruptcy courts – what counts as consent for the purposes of a consensual

[36] *Purdue Pharma*, 144 S. Ct. at 2087 (emphasis in original). One could perhaps raise the question whether even a party's affirmative consent provides a sufficient basis to justify the inclusion of a release of a non-debtor in a plan (as opposed to leaving the parties to enter into whatever arrangements they choose outside of bankruptcy, subject to all of the usual contractual requirements under non-bankruptcy law). But it has been settled law, even in jurisdictions that have always followed the *Purdue Pharma* rule and prohibited nonconsensual third-party releases, that consensual third-party releases were permissible. *See generally In re PG & E Corp.*, 617 B.R. 671, 683 (Bankr. N.D. Cal. 2020). That practice was not called into question in *Purdue* or raised by the parties here. The Court accordingly proceeds on the understanding that the only question it needs to resolve is what constitutes consent under that principle.

release? Is a release consensually given if creditors are notified (in clear and conspicuous language) that they will be deemed to give a release unless they elect to "opt out," with the creditor provided a simple mechanism (like checking a box on a form) to do so? Or does consent require a creditor affirmatively to indicate the creditor's agreement, such as by checking a box to "opt in"?

This Court addressed that question in *Arsenal*. There, the Court concluded that it was satisfied that the opt-out mechanism was appropriate. The premise of that conclusion, however, was called into question by *Purdue Pharma* and is thus appropriately reconsidered.

In *Arsenal*, the Court broadly characterized the then-existing caselaw as falling within one of two categories. One category of cases emphasized that the rights that a creditor holds against a third party are the *creditor's* property. Outside of bankruptcy, one generally cannot infer that a party has "consented" to an arrangement whereby the party will give up its property based on the party's silence. As Judge Bernstein explained in *SunEdison*, a party seeking to enter into a contract with another "cannot ordinarily force the other party into a contract by saying, 'If I do not hear from you by next Tuesday, I shall assume you accept.'"[37]

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[37] *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017). *See also Washington Mutual,* 442 B.R. at 352 (adopting similar reasoning); *Emerge Energy Services,* 2019 WL 7634308, at *18 (finding that, unlike in the context of claims objections or cure amounts, where creditors have a duty to respond, in the context of third-party releases "basic contract principles" are applicable and concluding that "while the Debtors included on the ballot and Opt-Out Form notice to the recipients of the implications of a failure to opt-out, the Court cannot on the record before it find that the failure of a creditor or equity holder to return a ballot or Opt-Out Form manifested their intent to provide a release. Carelessness, inattentiveness, or mistake are three reasonable alternative explanations.").

The response to Judge Bernstein, however, is that litigants certainly can be required to respond by a date certain to a pleading that is validly served on them or risk losing their legal rights. Courts do exactly that every day when they enter default judgments to parties that fail to respond to a properly served complaint. And the practice of "defaulting" parties that do not raise objections is necessarily a regular part of bankruptcy practice. When a debtor seeks, as part of the sale of a business, to assume and assign 20,000 executory contracts that are listed in a 300-page schedule in small print, courts do not inquire into whether each and every contractual counterparty has affirmatively consented to the listed cure amounts. Rather, courts will require that each of the counterparties be served with the motion. A counterparty that does not respond will be deemed to have "consented" to it. In this context, the word "consent" is used in a shorthand, and somewhat imprecise, way. It may be more accurate to say that the counterparty forfeits its objection on account of its default.

Does that mean that the Court expects that each contractual counterparty has opened the mail, found its agreement on the schedule, and determined that the listed cure amount is in fact correct? Of course not. As the Court noted in *Emerge Energy Services*, it is just as likely (or perhaps more likely) that any particular counterparty's failure to respond was a result of "[c]arelessness, inattentiveness, or mistake."[38] But in the context of the sale of the debtor's business, courts routinely conclude that creditors and other parties in interest who are validly served with motions and other

[38] *Id.*

bankruptcy pleadings choose to ignore them at their own peril. Just like a defendant in a civil action that may face a default judgment if the defendant fails to respond to a summons and complaint, a creditor in bankruptcy that is served with a sale motion, a claims objection, or a plan of reorganization is "deemed" to understand that the bankruptcy proceeding may affect their legal rights and faces the risk of forfeiting those rights if the creditor chooses to stay silent in the face of such a motion, objection, or plan.

This Court's reasoning in *Arsenal*, in which it concluded that the opt-out mechanism was generally permissible, relied on this rationale, which had been expressed by the bankruptcy courts in cases such as *DBSD*, *Indianapolis Downs*, *Mallinckrodt*, and *Boy Scouts*.[39] In this Court's view, under then-controlling law, a third-party release was just a provision contained in a plan of reorganization, not fundamentally different from any other. And the Court explained that a party that objected to such a provision was required to speak up by objecting to the inclusion of that provision, much like the contractual counterparty must if it disagrees with the cure amount listed in the schedule.[40]

The Court noted, however, that other courts had taken issue with that line of reasoning. The courts that had insisted on an opt-in mechanism for a third-party release respond to the point above by saying, in substance: "Wait a minute. It is one

[39] *See DBSD,* 419 B.R. at 218-219; *In re Indianapolis Downs, LLC*, 486 B.R. 286 (Bankr. D. Del. 2013); *In re Mallinckrodt PLC*, 639 B.R. 837, 879 (Bankr. D. Del. 2022); *In re Boy Scouts of America and Delaware BSA*, *LLC*, 642 B.R. 504, 675 (Bankr. D. Del. 2022).

[40] *Arsenal*, 2023 WL 2655592, at *6.

thing to say to creditors that their rights will be lost if they fail to focus on the bankruptcy pleadings when it comes to their rights vis-à-vis the *debtor*. That is a necessary part of the bankruptcy process. But there is no reason to impose that obligation on them with respect to their rights against *third parties*." Judge Wiles put that point clearly in *Chassix*:

> [M]any creditors may simply have assumed that a package that related to the Debtors' bankruptcy case must have related only to their dealings with the Debtors and would not affect their claims against other parties. Charging all inactive creditors with full knowledge of the scope and implications of the proposed third party releases, and implying a 'consent' to the third party releases based on the creditors' inaction, is simply not realistic or fair, and would stretch the meaning of 'consent' beyond the breaking point.[41]

Before *Purdue Pharma*, this Court believed there was a fair response to that point. At least in this jurisdiction, there was Circuit precedent holding (or, at the very least, strongly implying) that courts could grant *nonconsensual* third-party releases.[42] Whether the provision was appropriate in any particular case would of course depend on the evidence the debtor presented at the confirmation hearing – and the standard was certainly a high one. But in light of the circuit authority, there was nothing that categorically distinguished the third-party release from the schedule of executory contracts and cure amounts. It was a plan provision that might or might not be permissible, based on the evidence to be presented at a later hearing.

[41] *In re Chassix Holdings, Inc.*, 533 B.R. 64, 80-81 (Bankr. S.D.N.Y. 2015).

[42] *See Continental Airlines*, 203 F.3d at 203; *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000); *United Artists Theatre Co. v. Walton*, 315 F.3d 217 (3d Cir. 2003); *In re Global Industrial Technologies, Inc.*, 645 F.3d 201 (3d Cir. 2011) (en banc); *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019).

And a party that opposed that relief was under the same compulsory obligation as any other party on whom a motion, plan, or other pleading had been served. A party that does not file an appropriate objection runs the risk that their legal rights will be forfeited.

But this is what *Purdue Pharma* changes. After that decision, regardless of what facts the debtor may establish at the confirmation hearing, the third-party release is no longer a potentially permissible plan provision. Accordingly, it is no longer appropriate to require creditors to object or else be subject to (or be deemed to "consent" to) such a third-party release.

Longstanding doctrine in the context of the entry of default judgments in civil litigation under Rule 55 underscores this point. The District Court for the Middle District of Florida explained these principles clearly. Before entering a default judgment, "the Court must find that there is a sufficient basis in the pleadings for the judgment to be entered."[43] As the Eleventh Circuit explained it, a "default judgment cannot stand on a complaint that fails to state a claim."[44] Or in the Fifth Circuit's words, a default judgment is properly entered "only so far as it is supported by well-pleaded allegations, [which are] assumed to be true."[45] All that may be accomplished by the entry of a default, then, is that the "plaintiff's well-pleaded

[43] *GMAC Comm'l Mortgage Corp. v. Maitland Hotel Assoc.*, 218 F. Supp. 2d 1355, 1359 (M.D.Fla. 2002) (internal quotation and citation omitted).

[44] *Chudasama v. Mazda Motor Corp.*, 123 F.3d 1353, 1370 n. 41 (11th Cir.1997).

[45] *Nishimatsu Construction v. Houston National Bank*, 515 F.2d 1200, 1206 (5th Cir. 1975).

allegations of fact" are established as true.[46] If relief may not be afforded on those facts – and it is now clear under *Purdue Pharma* that there are no set of facts that would justify the imposition of third-party release – that relief is not properly granted upon the creditor's default.

The rationale of *Arsenal*, under which the opt-out plan was permitted on the ground that the creditor's failure to opt out operated as a default, does not survive *Purdue Pharma*. Accordingly, such releases cannot be described as "consensual" on the ground that the creditor's failure to assert an objection effectively allowed the release to be imposed by virtue of the creditor's default. And in the absence of some sort of affirmative expression of consent that would be sufficient as a matter of contract law, the creditor's silence in the face of a plan and form of ballot can no longer be sufficient.

The principle that the opt-out plan was justified on the grounds of a creditor's default also provided a basis for distinguishing between the "consensual" third-party release before *Purdue Pharma* and the college education fund plan (described above). The former was the kind of relief that a court could properly enter upon an opposing party's default; the latter is not. With that distinction eviscerated, there is no logical limiting principle to what a court might be able to do on the grounds that a creditor threw away the plan and the ballot, and thus "consented" to it. To be sure, a litigant who throws away a validly served legal pleading does so at that litigant's risk. That risk, however, is limited to relief that can lawfully be entered against that litigant if

[46] *GMAC Comm'l Mortgage*, 218 F. Supp. 2d at 1359.

the allegations in the pleading are true. That risk does not include the possibility that a creditor will be required to contribute to the college education fund. And after *Purdue Pharma*, it no longer includes the risk that the creditor will release a cause of action it may have against a third party.

The *Purdue Pharma* Court's discussion of the Bankruptcy Code's different treatment of direct versus derivative claims drives home this point. The dissenting opinion had argued that the fact that a debtor may resolve a creditor's *derivative* claims against third parties suggested that the bankruptcy authority was not limited to restructuring the relationship between the debtor and its creditors.[47] The majority opinion, however, responded by explaining that the whole point of a claim being *derivative* is that the claim is *not* the creditor's claim. Rather, the claim is property of the estate, and is thus the debtor's to settle or not settle.[48] The third-party release, however, "is nothing like that."[49] Rather than being a claim that belongs to the debtor, the third-party release "seeks to extinguish claims against the [third parties] that belong to [the creditors]."[50]

That point is strikingly similar to the one made by Judge Wiles in *Chassix*. It is reasonable to require creditors to pay attention to what the debtor is doing in bankruptcy as it relates to the creditor's rights against the debtor. But as to the creditor's rights against third parties – which belong to the creditor and not the

[47] *Purdue Pharma*, 144 S. Ct. at 2107- 2108 (Kavanaugh, J., dissenting).

[48] *Id.* at 2083-2084.

[49] *Id.* at 2084.

[50] *Id.*

bankruptcy estate – a creditor should not expect that those rights are even subject to being given away through the debtor's bankruptcy. In that context, "implying a 'consent' to the third-party releases based on the creditors' inaction, is simply not realistic or fair, and would stretch the meaning of 'consent' beyond the breaking point."[51] Indeed, while the Court appreciates that inferring consent by silence to a third-party release may, to seasoned bankruptcy professionals, "feel" different from inferring consent to the contribution to the college education fund, the only basis for that is the residue of the world as it existed before *Purdue Pharma*. There is no longer any principled basis for drawing a line between the two.

Accordingly, whatever one might think about the propriety of third-party releases in the world before *Purdue Pharma*, this Court concludes that in light of that decision, there is no longer a basis to argue with the conclusion in cases like *Washington Mutual*, *Emerge Energy*, *SunEdison*, or *Chassix*. While the undersigned had previously been comfortable, for the reasons described in *Arsenal*, concluding that creditors that failed to opt out may be deemed to consent to a plan's third-party release, the Court no longer believes it is appropriate to do so.

B. Decisions addressing the issue since *Purdue Pharma* reinforce this conclusion.

A number of thoughtful bankruptcy court decisions, issued since *Purdue Pharma*, have addressed this question. In *Bowflex*, Judge Altenberg emphasized the same due process principles on which this Court relied in *Arsenal*. In finding that a

[51] *Chassix*, 533 B.R. at 81.

creditor that receives clear and conspicuous notice of a third-party release is required to assert an objection if the creditor does not consent to the release, Judge Alternberg noted that "it is incumbent upon parties who have been properly served with pleadings to protect their own rights."[52] Judge Lopez' decision in *Robertshaw* is to similar effect, emphasizing that the third-party release was clearly and conspicuously disclosed to all creditors, and that every creditor had the opportunity to opt out of the release.[53]

None of these cases, however, articulates a limiting principle. This Court does not believe that the courts in *Bowflex*, *Robertshaw*, or *Invitae* would have confirmed a plan that required creditors to donate to the college education fund. The reasoning of those cases, however, suggests no principle that would distinguish the "consensual" third-party releases they approved from a plan provision requiring such a

[52] *In re Bowflex, Inc.* Bankr. D.N.J. No. 24-12364, Aug. 19, 2024 Hr'g Tr. at 67. *See also In re Invitae Corp.*, Bankr. D.N.J. No. 24-11362, July 23, 2024 Hr'g Tr. at 14.

[53] *In re Robertshaw US Holding Corp.*, Bankr. S.D. Tex. No. 24-90052, Memorandum Decision on Plan Confirmation (Aug. 16, 2024), D.I. 959 at 29. There is, however, a relevant difference between *Robertshaw* on the one hand and *Bowflex* and *Invitae* on the other. In *Robertshaw*, the bankruptcy court noted that even before *Purdue Pharma*, Fifth Circuit law had prohibited nonconsensual third-party releases. *See, e.g., In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009). But settled practice in that jurisdiction had nevertheless long permitted opt-out releases. So unlike courts located in the Third Circuit, the court in *Robertshaw* certainly had a fair argument that *Purdue Pharma* made no difference in governing law.

Another point in *Robertshaw* warrants mention. The decision in that case emphasized that under Rule 23, opt outs are permissible in class action cases involving claims for damages. *Robertshaw* at 28 n.120. While that is true, the critical difference is that in the class action context, a class is only certified after a court makes a factual finding that the named representative is an appropriate representative of the unnamed class members. In the plan context, there is no named plaintiff, found by the court to be an adequate representative, whose actions may presumptively bind others. As set forth in Part II.E, *infra*, the Court would be open to the argument that an opt-out regime would be appropriate if the plan process were to replicate the requirements of Rule 23(b)(3).

contribution. In the face of the college education fund plan, one could equally assert, just as the *Bowflex* court did, that it is "incumbent on parties who have been properly served with pleadings to protect their rights."[54]

The part of the analysis that these decisions omit is that the obligation of a party served with pleadings to appear and protect its rights is limited to those circumstances in which it would be appropriate for a court to enter a default judgment if a litigant failed to do so. As described above, that is no longer the case in the context of a third-party release.

The Court finds the reasoning of the bankruptcy court in *In re Ebix* to be more persuasive.[55] That court noted that bankruptcy courts regularly grant relief that is sought in a motion or under a plan when it is unopposed (consider the omnibus claims objection or schedule of cure amounts). The *Ebix* court pointed out that "in those examples, there is consistently a basis in either the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure or other substantive law contemplating and authorizing that relief."[56] Because there is no such authority to impose a third-party release, the *Ebix* court found that such releases were only appropriate in circumstances in which, following a contract model, there was evidence of an agreement to grant the release.[57] This Court is persuaded by that reasoning. That leaves only the task of applying these principles to the present case.

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[54] *Bowflex*, Aug. 19, 2024 Hr'g Tr. at 67.

[55] *In re Ebix, Inc.*, Bankr. N.D. Tex. No. 23-80004, Aug. 2, 2024 Hr'g Tr.

[56] *Id.* at 11-12.

[57] *See also In re Tonawanda Coke Corp.*, Bankr. W.D.N.Y. No. 18-12156, Decision and Order (Aug. 27, 2024), D.I. 790 at 4 of 6 (applying contract model, after *Purdue Pharma*, to

C. Unimpaired creditors who are not solicited have not affirmatively expressed consent to the release; the Court is not persuaded, in the circumstances of this case, that a release should be imposed on the basis that these creditors' claims will be paid in full.

Under the plan at issue here, priority creditors are to be paid in full and are thus deemed to accept the plan. And the debtors' equity holders were unimpaired, and also presumed to accept. As such, those parties were not solicited to vote on the plan and were never given an opportunity to opt out. It is true that these parties were informed that the plan would operate to release their claims against third parties. So, under the reasoning of *Arsenal*, this Court would have found that it was incumbent on those parties to raise an objection if they did not in fact consent to the granting of the third-party release. For the reasons described above, however, that rationale does not survive *Purdue Pharma*. And as a matter of ordinary contract law, those parties' silence, in the face of language in the plan telling them that they would be giving the third-party release, is insufficient to bind them to it. "It is certain that, if the only facts are that A makes an offer to B, and B remains

consensual third-party release). Note that the *Tonawanda Coke* court engaged a choice-of-law analysis and applied New York state law to the question whether the creditors had adequately manifested consent. The *Tonawanda Coke* court may well be correct that the question of consent is controlled by state rather than federal law. *But see Field v. Mans,* 516 U.S. 59 (1995) (holding that the question of what level of reliance on a misrepresentation is required to show that a debt was obtained by means of fraud under § 523(a)(2) of the Bankruptcy Code turned on federal rather than state law, but looking to the prevailing view among the states to resolve that question). In the absence of any suggestion by any party that there are differences among any of the potentially applicable state laws on these issues, however, the Court does not believe it necessary to resolve that issue here.

silent, there is no contract."[58] The Court accordingly will not find that the creditors who were not solicited to vote have validly consented to giving the third-party releases. [59]

It bears note, however, that *Purdue Pharma* also left open the possibility that a *nonconsensual* third-party release might be appropriate in a "paid-in-full plan." The Court did not elaborate on what it meant by that. At some level, there may be a common sense to the notion that creditors who have suffered a single, indivisible injury, caused jointly by the debtor and non-debtors, and whose claims on account of that injury have been satisfied in full out of the bankruptcy estate, ought not be permitted to assert those same claims against non-debtors. No party, however, has suggested that this is a basis on which the releases in this case may be justified. The Court therefore does not believe this is an appropriate case to explore the contours of this paid-in-full doctrine, assuming (without deciding) that such a doctrine is even a thing.

[58] 1 *Corbin on Contracts* § 3.18. *See also Restatement (Second) of Contracts* § 69, cmt. a ("Ordinarily an offeror does not have power to cause the silence of the offeree to operate as acceptance.").

[59] *See In re Kettner Investments, LLC,* Bankr. D. Del. No. 20-12366 (KBO), Feb. 15, 2022 Hr'g Tr. at 53 ("As for the unimpaired deemed to accept claims and interest holders, I also don't believe it's appropriate on this record to find that they have consented to the release…. These parties have had no opportunity to opt in and express their affirmative assent and agreement.").

D. Those class 2 creditors who voted, after receiving clear instruction that such a vote would operate to grant a release unless they opted out, and who were given a simple mechanism to opt out, may be deemed to have given the release.

The Court finds that regardless of how class 2 creditors voted on the Plan, the vote is an affirmative step, and coupled with conspicuous notice of the opt-out mechanism, suffices as consent to the third-party releases under general contract principles. As to those creditors in class 2 who voted *in favor* of the plan and elected not to opt out, the Court is satisfied that the plan releases are valid and appropriate as a matter of ordinary contract law. Creditors who returned their ballots and voted in favor of the plan after being informed that doing so, unless they checked the box to opt out, have not been silent. They have taken an affirmative step. And under ordinary contract principles, what they have done is sufficient to hold them to the terms of the release.

In this respect, these creditors are in a position analogous to that of a consumer that makes a purchase over the internet, and "clicks through" to accept the terms and conditions of the sale. The Ninth Circuit explained that such action is typically sufficient to give rise to an enforceable agreement. An "enforceable contract will be found based on an inquiry notice theory only if: (1) the website provides reasonably conspicuous notice of the terms to which the consumer will be bound; and (2) the consumer takes some action, such as clicking a button or checking a box, that unambiguously manifests his or her assent to those terms."[60]

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[60] *Berman v. Freedom Financial Network*, 30 F.4th 849, 856 (9th Cir. 2022). *See also Meyer v. Uber Technologies, Inc.,* 868 F.3d 66, 75 (2d Cir. 2017).

Returning a ballot that contains a vote in favor of the plan after being expressly instructed that doing so will manifest agreement to a third-party release unless the creditor checks a box to opt out is no different than clicking through. That is sufficient, as a matter of general contract principles, to bind the party to the terms of the release.[61] And because the creditor had a simple means of opting out, unlike the form of ballot used in this case for class 1 in which creditors who voted in favor of the plan were denied that option, there is no reason to be concerned that this mechanism would discourage creditors from voting or distort the voting process.

The same rationale applies to those creditors in class 2 who voted against the plan and elected not to opt out. They were provided clear instruction that a vote against the Plan would suffice to manifest agreement to a third-party release if they did not affirmatively opt-out by marking the box on the ballot.[62] A vote against the plan serves as evidence that the creditor was on notice and actively engaged, and thus has taken an affirmative step such that consent can be established to bind the party to the terms of the release.

The Court appreciates Judge Wiles' position in *Chassix*, that "it [is] difficult to understand why any other action should be required to show that the creditor [who voted to reject the plan] also objected to the proposed third party releases… The additional 'opt out' requirement, in the context of this case, would have been little

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[61] *See In re Jamby's, Inc.*, Bankr. D. Del. No. 24-10913 (KBO), Sept. 10, 2024 Hr'g Tr. at 58 ("[T]he creditor read the ballot and chose to vote in favor of the plan. They took affirmative steps here.… They did not opt out. So they affirmatively checked the box to vote on the plan and they did not opt out. That, to me, is sufficient manifestation of consent to the release.").

[62] D.I. 181-1 at 14 of 34.

more than a Court-endorsed trap for the careless or inattentive creditor."[63] Under the Bankruptcy Code, however, the creditor's vote is intended to indicate only whether the creditor does or does not accept the plan's *treatment* of the creditor's allowed claim. As to consent to the third-party release, the touchstone is whether the creditor engaged in affirmative conduct to indicate the creditor's consent. For the creditor who voted in favor of the plan, the act of casting the vote, in light of the clear instructions and the failure to check the available box to "opt out," was a sufficient action to say that the creditor had evidenced its consent. On this rationale, there is no basis to distinguish between the creditor who voted in favor of the plan from the one who voted against it.

E. The Court need not address here whether a different outcome would be appropriate in a case in which the plan process built in the protections of Rule 23.

The Court also seeks to emphasize a further issue that today's decision does not decide. In a recent article, two leading practitioners suggest that in the mass tort context, particularly in a case in which there is a factual basis for a court to make findings akin to those that a court makes when it certifies a Rule 23(b)(3) class action, a bankruptcy court can and should treat an estate fiduciary as a class representative, giving that representative the authority to bind absent class members, subject to those members receiving individual notice and being afforded the opportunity to opt out.[64] There may well be merit to that point. There are also challenges. In some

[63] *Chassix*, 533 B.R. at 79.

[64] *See* Marshall S. Huebner and Kate Somers, *Opting Into Opting Out: Due Process and Opt Out Releases*, 43 Am. Bankr. Inst. J. (Aug. 2024) at 26.

mass torts, for example, the reason that bankruptcy has become the last resort is that the plaintiffs lacked sufficient commonality to permit the defendant to obtain a global resolution through a Rule 23 class action.[65] That question is not presented in this case. But nothing in the Court's rejection of the opt-out release in the circumstances presented here should be construed to foreclose reaching a different outcome in a circumstance such as the one presented in that article.

* * *

As noted above, the Court is sympathetic to the argument that a different outcome might better serve the underlying purposes of bankruptcy law, particularly the objectives of encouraging the fair resolution of parties' disputes in a way that grants all parties a measure of finality. But this Court's application of ordinary and settled legal principles leads it to conclude that there is no longer a legal basis to distinguish a traditional opt-out plan from the college education fund plan, which no bankruptcy court would confirm.

That said, this should hardly pose an insurmountable barrier to the successful reorganization of most troubled businesses and their ability to obtain a measure of finality through the bankruptcy process. Nothing in *Purdue Pharma* can be read to call into question the kind of exculpation approved by the Third Circuit in *In re PWS*.[66] Nor is there a reason why, under *Emoral*, a debtor may not reach an appropriate resolution of an estate cause of action and thereby relieve third parties

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[65] *See Amchem Prods. v. Windsor*, 521 U.S. 591 (1997).

[66] *PWS Holding*, 228 F.3d at 246.

of potential liability on alter-ego or veil-piercing claims.[67] In addition, as further described above, the more modest form of opt-out plan that the debtor employed here involves sufficient manifestation of creditor consent to permit the enforcement of those releases. And finally, the Court is at least open to the possibility that it may be appropriate to build class action protections into the plan process, and thus allow a named representative to act on behalf of creditors who do not affirmatively opt out. Creative lawyers will undoubtedly dream up other tools, which will be considered, when presented, on their merits in light of applicable law. But on the record now before it, this Court concludes that the plan's releases for those creditors who have not voted on the plan cannot be described as consensual, and therefore are not valid.

Conclusion

The parties are directed to settle an appropriate order reflecting the foregoing ruling.

Dated: September 25, 2024

CRAIG T. GOLDBLATT
UNITED STATES BANKRUPTCY JUDGE

[67] *Emoral*, 740 F.3d at 875.

APPENDIX A

Language in Confirmation Notice Apprising Creditors of Plan's Third-Party Release

On the Effective Date, except as otherwise provided herein and except for the right to enforce this Plan, all persons (i) who voted to accept this Plan or who are presumed to have voted to accept this Plan and (ii) who voted to reject this Plan but did not affirmatively mark the box on the ballot to opt out of granting the releases provided under this Plan, under section 1126(f) of the Bankruptcy Code shall, to the fullest extent permitted by applicable law, be deemed to forever release, and waive the Released Parties of and from all liens, claims, causes of action, liabilities, encumbrances, security interests, interests or charges of any nature or description whatsoever based or relating to, or in any manner arising from, in whole or in part, the Chapter 11 Case or affecting property of the Estate, whether known or unknown, suspected or unsuspected, scheduled or unscheduled, contingent or not contingent, unliquidated or fixed, admitted or disputed, matured or unmatured, senior or subordinated, whether assertable directly or derivatively by, through, or related to any of the Released Parties and their successors and assigns whether at law, in equity or otherwise, based upon any condition, event, act, omission occurrence, transaction or other activity, inactivity, instrument or other agreement of any kind or nature occurring, arising or existing prior to the Effective Date in any way relating to or arising out of, in whole or in part, the Debtor, the Debtor's prepetition operations, governance, financing, or fundraising, the purchase or sale of the Debtor's securities, the Chapter 11 Case, the pursuit of Confirmation of this Plan, the consummation of this Plan or the administration of this Plan, including without limitation, the negotiation and solicitation of this Plan, the DIP Loan, and the DIP Loan Documents, all regardless of whether (a) a Proof of Claim or Equity Interest has been filed or is deemed to have been filed, (b) such Claim or Equity Interest is allowed, or (c) the Holder of such Claim or Equity Interest has voted to accept or reject this Plan, except for willful misconduct, gross negligence, fraud or criminal misconduct; provided, however, that the Debtor shall not be a Released Party until the Last Distribution Date if the Plan is confirmed under section 1191(b) of the Bankruptcy Code. Nothing contained herein shall impact the right of any Holder of an Allowed Claim or interest to receive a Distribution on account of its Allowed Claim or Allowed Interest in accordance with this Plan.

MANDATORY AGGREGATION OF MASS TORT LITIGATION IN BANKRUPTCY

131 YALE L.J.F. 960 (2022)

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This response to Professor Lindsey Simon's *Bankruptcy Grifters* article challenges the controversial practice at the epicenter of the bankruptcy grifter phenomenon that Simon critiques: so-called nonconsensual nondebtor (or third-party) "releases" and "channeling" injunctions that discharge the mass tort obligations of solvent nondebtor entities who have not themselves filed bankruptcy. These nondebtor releases are an illegitimate and unconstitutional exercise of substantive lawmaking powers by the federal courts that contravenes the separation-of-powers limitations embedded in both the Bankruptcy Clause and *Erie*'s constitutional holding. The federal courts have manufactured out of whole cloth the unique, extraordinary power to impose mandatory non-opt-out settlement of a nondebtor's mass tort liability on unconsenting tort victims through the bankruptcy proceedings of a codefendant. The bankruptcy "necessity" that supposedly justifies this astounding and unique settlement power—to mandate nonconsensual non-opt-out "settlements" that are otherwise impermissible and unconstitutional—is (at best) naive credulity or (at worst) specious sophistry.

Nonconsensual nondebtor releases are not "necessary" for the bankruptcy process to facilitate efficient aggregate settlements of the mass tort liability of both bankruptcy debtors and nondebtor codefendants. The bankruptcy jurisdiction, removal, and venue provisions of the Judicial Code already contain the essential architecture for mandatory, universal consolidation of tort victims' claims against *both* bankruptcy debtors *and* nondebtor codefendants. Bankruptcy can be an extremely powerful aggregation process that facilitates efficient (and fair) settlements of the mass tort liability of nondebtors, even (and especially) without nonconsensual nondebtor releases, particularly if the Supreme Court elucidates the full expanse of federal bankruptcy jurisdiction. Nondebtor releases are an illicit and unconstitutional means of forcing mandatory settlement of unconsenting tort victims' claims against solvent nondebtors, and the Supreme Court should finally resolve the longstanding circuit split over the permissibility of nonconsensual nondebtor releases by categorically renouncing them.

Keywords: nondebtor releases, third-party releases, channeling injunctions, nondebtor discharge, the *Erie* doctrine, the Bankruptcy Power, the Bankruptcy Clause, federalism, separation of powers, Chapter 11 bankruptcy reorganizations, mass tort bankruptcies, mandatory settlement, non-opt-out settlement, multidistrict litigation, MDL consolidations, class actions, nonclass aggregation, mandatory consolidation, mandatory aggregation

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Mandatory Aggregation of Mass Tort Litigation in Bankruptcy

Ralph Brubaker

ABSTRACT. This Response to *Bankruptcy Grifters* by Lindsey Simon shares her concerns about the inequities of a solvent entity, which has not filed bankruptcy, discharging its mass tort liability in the bankruptcy proceedings of a codefendant. Such a nondebtor discharge, effectuated through a so-called nondebtor release and channeling injunction, imposes upon tort victims a mandatory non-opt-out settlement of the released nondebtor's mass tort liability. Simon's proposed reforms of nondebtor-release practice do not go far enough. Nondebtor releases are an illegitimate and unconstitutional exercise of substantive lawmaking powers by the federal courts. Moreover, the bankruptcy "necessity" proffered as justifying a mandatory settlement of nondebtors' mass tort liability—a mandatory settlement that is otherwise impermissible and unconstitutional—is nothing more than pretext. The Supreme Court should resolve the circuit split over the permissibility of nondebtor releases by flatly repudiating them. Bankruptcy can serve as a powerful aggregation process for efficient (and fair) resolution of the mass tort liability of *both* debtors *and* nondebtor codefendants even (and especially) without nondebtor releases, particularly if the Supreme Court also clarifies the full expanse of federal bankruptcy jurisdiction.

INTRODUCTION

Professor Lindsey Simon's fascinating and revealing article, *Bankruptcy Grifters*,[1] comes in the midst of a collective epiphany regarding the astonishing means by which federal bankruptcy courts impose mandatory settlements of mass tort liabilities. Of course, with respect to an insolvent debtor's liability, such a power has always been incident to collective insolvency proceedings, even before the

1. Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154 (2022).

II. JUSTIFYING AN EXTRAORDINARY MANDATORY SETTLEMENT POWER ONLY IN BANKRUPTCY

As Simon points out, the judicially decreed criteria for approval of nonconsensual nondebtor releases do not replicate the Bankruptcy Code's substantive and procedural protections for the third-party nondebtor claims being discharged thereby.[94] For example, in conjunction with a Chapter 11 debtor's discharge, each and every creditor has the right to insist that it receive at least as much under the debtor's plan of reorganization as that creditor would receive in a liquidation of the debtor's assets.[95] Indeed, as Simon discusses,[96] if the courts were to impose such a requirement in conjunction with nondebtor releases, particularly for solvent nondebtors, many (if not all) releases could never be approved.[97] And for individual nondebtors, releases shield the individual from liability (and, indeed, from even being sued and the accompanying public scrutiny)

94. Simon, *supra* note 1, at 1206-15; *see also* Brubaker, *supra* note 3, at 980-1001 (explicating the many ways in which nondebtor releases are inconsistent with the Bankruptcy Code).

95. This is the so-called "best interests of creditors" requirement for confirmation of a plan of reorganization, set forth in 11 U.S.C. § 1129(a)(7) (2018).

96. Simon, *supra* note 1, at 1212-13.

97. *See* Brubaker, *supra* note 3, at 991-93. And on those occasions that courts have imposed such a requirement, it has typically been fatal to approval. *See, e.g.*, *In re* Ditech Holding Corp., 606 B.R. 544, 606-21 (Bankr. S.D.N.Y. 2019).

for alleged fraud and other intentional misconduct,[98] which the Bankruptcy Code provides can*not* be discharged.[99]

Equally if not more importantly, though, approval of nondebtor releases also does not replicate nonbankruptcy standards for resolution of disputed claims.[100] As the discussion in Section I.A reveals, by simply granting the federal courts "related to" bankruptcy jurisdiction over third-party nondebtor claims, the statutory design (pursuant to *Erie*) is for those claims to be heard and adjudicated in federal court, if at all, according to applicable nonbankruptcy substantive law

98. Through the smoke and mirrors of the so-called "channeling" injunction, *see supra* note 11, the fraud or intentional-tort claim against the individual debtor is extinguished, "leav[ing] the creditor with only its claim against the debtor's estate, without even purporting to address the merits of the released non-debtor claim." Brubaker, *Nondebtor Release Jurisdiction*, *supra* note 11, at 19. When the individual nondebtor was acting as an agent on behalf of a corporate debtor with respect to the alleged misconduct, then, nondebtor releases essentially assign primary (and *exclusive*) responsibility for that agent's misconduct to the corporate debtor. That, however, turns the relative responsibility for such tortious misconduct completely upside down and (even worse) collapses the individual's primary responsibility into nothingness:

> A corporate agent who engages in wrongful conduct, such as fraud, is directly responsible [to fraud victims] as a tortfeasor and is not shielded from liability by virtue of the fact that the agent's fraudulent conduct was taken on behalf of a corporate principal. Because a corporation (a fictional person) cannot "do" anything, except through the actions of its corporate agents (real people), the corporation's fraud liability is purely *vicarious* liability, through which the corporation (*i.e.*, the corporate property) is *also* subjected to liability for the corporate agent's fraudulent conduct.

Ralph Brubaker, *Taking Exception to the New Corporate Discharge Exceptions*, 13 AM. BANKR. INST. L. REV. 757, 772 (2005) [hereinafter Brubaker, *Corporate Discharge Exceptions*] (footnotes omitted); *see also In re* Purdue Pharma, L.P., No. 21 cv 7532, 2021 WL 5979108, at *29-30 (S.D.N.Y. Dec. 16, 2021) (perceptively recognizing that involuntarily released "claims against the [nondebtor] Released Parties are effectively being extinguished for nothing, even though they are described as being 'channeled'" and emphasizing that the "Debtors sidestepped" that inconvenient fact and "made no effort to clarify this"). The nondebtor-release factor that justifies extinguishing the corporate agent's primary liability based upon "an identity of interest between the debtor and the third party . . . such that a suit against the non-debtor is, in essence, a suit against the debtor," Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002), is the distracting shiny object that makes this "channeling sleight of hand" possible. Brubaker, *Nondebtor Release Jurisdiction*, *supra* note 11, at 19; *see* Brubaker, *Corporate Discharge Exceptions*, *supra*, at 772-73, 773 n.84.

99. *See, e.g.*, 11 U.S.C. § 523(a)(2), (6) (2018); Brubaker, *supra* note 3, at 999-1001; Posner & Brubaker, *supra* note 7. Approving discharge of such debts via nonconsensual nondebtor release, therefore, is not an appropriate exercise of a bankruptcy court's general equitable powers. *Accord Purdue Pharma*, 2021 WL 5979108, at *62; *see* Law v. Siegel, 571 U.S. 415, 421 (2014) ("Section 105(a) confers authority to 'carry out' the provisions of the Code, but it is quite impossible to do that by taking action that the Code prohibits. That is simply an application of the axiom that a statute's general permission to take actions of a certain type must yield to a specific prohibition found elsewhere.").

100. *See* Brubaker, *supra* note 3, at 972-80.

and the incident procedural apparatus for adjudicating those claims, such as the Federal Rules of Bankruptcy Procedure (which incorporate nearly all of the Federal Rules of Civil Procedure[101]). The extraordinary resolution of those claims effected via nondebtor release, however, is unknown to any of those governing sources of substantive or procedural law. And there is no bankruptcy-unique normative or policy justification for nondebtor releases' exceptional alteration of the parties' nonbankruptcy rights and obligations.

A. Mandatory Settlement via Nondebtor Release

Nondebtor releases are often clothed in the rhetoric of "compromise" and "settlement" of the third-party nondebtor claims at issue. Given the nonconsensual nature of the nondebtor releases of concern, though, the "settlement" effectuated via nondebtor release departs from the fundamental baseline norm that settlement of a claim cannot be imposed on a party without that party's consent.[102] That principle is undoubtedly borne of constitutional due-process guaranties, as "part of our 'deep-rooted historic tradition that everyone should have his own day in court.'"[103]

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101. *See* FED. R. BANKR. P. 7001-7071, 9014(a)-(c); TABB & BRUBAKER, *supra* note 53, at 925-28. Consequently, "[b]ankruptcy practice, especially bankruptcy litigation, is governed in large measure, by the same rules of procedure that apply in general federal civil practice." Christopher M. Klein, *Bankruptcy Rules Made Easy (2001): A Guide to the Federal Rules of Civil Procedure That Apply in Bankruptcy*, 75 AM. BANKR. L.J. 35, 35-36 (2001).

102. *See* Martin v. Wilks, 490 U.S. 755, 761-62, 768 (1989) ("[A] voluntary settlement . . . cannot possibly 'settle,' voluntarily or otherwise, the conflicting claims of [those] who do not join in the agreement."); Loc. No. 93, Int'l Ass'n of Firefighters v. City of Cleveland, 478 U.S. 501, 529 (1986) ("Of course, parties who choose to resolve litigation through settlement may not dispose of the claims of a third party . . . without that party's agreement."). As Professor Richard A. Nagareda aptly noted, "[w]ords like 'peace,' 'settlement,' and 'resolution' have a certain soothing tone to them. When we hear those words in connection with mass torts, however, we also should hear the word 'coercion.'" RICHARD A. NAGAREDA, MASS TORTS IN A WORLD OF SETTLEMENT 219 (2007).

103. Martin v. Wilks, 490 U.S. at 762 (quoting 18 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4449, at 417 (1st ed. 1981)). *See generally* Douglas Laycock, *Consent Decrees Without Consent: The Rights of Nonconsenting Parties*, 1987 U. CHI. LEGAL F. 103 (examining the due-process rights of nonparties to consent decrees). The "day in court" sobriquet, however, only imperfectly captures the nature of the due-process right. A more accurate appellation is that which the text of the Due Process Clauses protects and which an inchoate cause of action is characterized as for purposes thereof: property belonging to the claimant. *See* NAGAREDA, *supra* note 102, at 60; Ryan C. Williams, *Due Process, Class Action Opt Outs, and the Right Not to Sue*, 115 COLUM. L. REV. 599, 618-44 (2015).

Nondebtor releases, therefore, work a kind of representational settlement, akin to a class-action settlement, in which someone else is negotiating and compromising creditors' claims against released nondebtors. As I have noted before, nonconsensual nondebtor releases impose a mandatory non-opt-out settlement of creditors' third-party nondebtor claims, wholly without regard to whether such a mandatory non-opt-out settlement is appropriate, permissible, or even constitutional.[104]

The approval process for nondebtor releases does not adhere to the constitutional due-process requirement of an adequate unconflicted litigation representative for the third-party nondebtor claims compromised thereby.[105] Even

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104. Brubaker, *supra* note 3, at 974-80.

105. *See* Taylor v. Sturgell, 553 U.S. 880, 900-01 (2008); Richards v. Jefferson Cnty., 517 U.S. 793, 798-802 (1996); Hansberry v. Lee, 311 U.S. 32, 40-46 (1940). "[N]o such representative speaks for the interests of any properly constructed 'class' of creditors whose non-debtor claims are extinguished through non-debtor releases." Brubaker, *supra* note 3, at 976; *accord* Patterson v. Mahwah Bergen Retail Grp., No. 21cv167, 2022 WL 135398, at *29-30 (E.D. Va. Jan. 13, 2022) (noting that "in the context of a non-debtor release in a bankruptcy action . . . no party litigates on behalf of the" releasing claimants, and since releasing claimants "had no one to adequately represent their interests . . . allowing the release of claims . . . does not comport with due process"); *In re* Aegean Marine Petroleum Network Inc., 599 B.R. 717, 724 (Bankr. S.D.N.Y. 2019) (noting that "[w]hen third-party releases are proposed," releasing claimants are not "adequately protected by court-certified . . . representatives" with "similar claims, who have incentives to pursue them, and who can be trusted to litigate or settle the . . . claims in a way that will fully protect the . . . interests" of the releasing claimants). Indeed, the representative of the debtor's bankruptcy estate (the trustee or debtor-in-possession) or collective claimant constituencies (such as official and unofficial committees) lack any authority or standing whatsoever to assert the claims of individual creditors against a nondebtor. *See* Caplin v. Marine Midland Grace Tr. Co., 406 U.S. 416 (1972). Moreover, any decision to permit such a representative assertion of creditor claims against nondebtors "is one that only Congress can make." *Id.* at 435. And as the Supreme Court has made clear, "virtual representation" simply from an alignment of interests does not satisfy due process because that would improperly "allow[] courts to 'create *de facto* class actions at will.'" Taylor v. Sturgell, 553 U.S. at 901 (quoting Tice v. Am. Airlines, Inc., 162 F.3d 966, 973 (7th Cir. 1998)). *Contra In re* Purdue Pharma L.P., 633 B.R. 53, 82, 86 (Bankr. S.D.N.Y.) (stating that "those who negotiated the plan's [nondebtor-release] settlements in essence represented all of the creditors in these cases"), *vacated*, No. 21 cv 7532, 2021 WL 5979108 (S.D.N.Y. Dec. 16, 2021).

Lack of adequate representation is also a significant structural deficiency of many non-class-action aggregate settlements. *See* ELIZABETH CHAMBLEE BURCH, MASS TORT DEALS: BACKROOM BARGAINING IN MULTIDISTRICT LITIGATION 94-96, 117, 131, 178-80, 208 (2019); Abbe R. Gluck & Elizabeth Chamblee Burch, *MDL Revolution*, 96 N.Y.U. L. REV. 1, 12-15, 67-71 (2021); Linda S. Mullenix, *Aggregate Litigation and the Death of Democratic Dispute Resolution*, 107 NW. U. L. REV. 511, 554-55 (2013). *See generally* Samuel Issacharoff, *The Governance Problem in Aggregate Litigation*, 81 FORDHAM L. REV. 3165 (2013) (analyzing representation and control issues in aggregate litigation); Howard Erichson, *Beyond the Class Action: Lawyer Loyalty and Client Autonomy in Non-Class Collective Representation*, 2003 U. CHI. LEGAL F. 519 (analyzing attorney representation issues in aggregate litigation).

more significantly, claimants are not provided any opportunity to opt out of the "settlement" imposed on them via nondebtor release.[106] In a series of decisions over the last thirty-five years, the Supreme Court has repeatedly and strongly suggested, if not explicitly held, that for the kinds of money damages claims typically compromised via nondebtor release, the "absence of . . . opt out violates due process."[107] Within the due-process triad of exit, loyalty, and voice,[108] then, nonconsensual nondebtor releases deny claimants both loyalty and by definition exit. In addition to their facial unconstitutionality on separation-of-powers grounds,[109] nondebtor releases thus raise grave due process concerns.[110]

In her article, Simon expresses no opinion on whether nonconsensual nondebtor releases are permissible or constitutional under existing law. Rather, her acceptance of nondebtor releases is a more practical response to the realities of existing nondebtor-release practice. She proposes salutary reforms, but her proposals would not alter the basic nature of any settlement produced by nonconsensual nondebtor release as a *mandatory* non-opt-out settlement.[111]

It is worth reemphasizing the unique and extraordinary nature of these nonconsensual nondebtor release "settlements," which simply *cannot* occur in any

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106. *See* Brubaker, *supra* note 3, at 978-80.

107. Wal-Mart Stores, Inc. v. Dukes, 564 U.S. 338, 362-63 (2011); *see* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 349 (2011); Ortiz v. Fibreboard Corp., 527 U.S. 815, 847-48 (1999); Phillips Petroleum Co. v. Shutts, 472 U.S. 797, 811-12 (1985); Williams, *supra* note 103, at 606-11.

108. *See* AM. L. INST., PRINCIPLES OF THE L. OF AGGREGATE LITIG. § 2.07 & cmts. & reporters' notes (2010) (discussing the relationship between claimants' due-process rights and preclusive effect of aggregate proceedings); *id.* cmt. c, at 148 (organizing "various due process rights in terms of the typology of exit, voice, and loyalty rights often used to describe the array of ways that individuals might advance their interests within a variety of arrangements that are collective or aggregative in nature").

109. *See supra* Part I.

110. Indeed, "third-party releases strike at the heart of [claimants'] foundational [due process] rights." *Patterson*, 2022 WL 135398, at *1. And to the extent that nondebtor releases violate claimants' due process rights, they may be subject to collateral attack. *See* AM. L. INST., *supra* note 108, § 2.07 & cmt. b, at 148 ("Strictures of constitutional due process comprise the most significant constraints on the preclusive effect of the aggregate proceeding."). *See generally* Debra Lynn Bassett, *Just Go Away: Representation, Due Process, and Preclusion in Class Actions*, 2009 BYU L. REV. 1079 (discussing the relationship between due-process right to adequate representation and preclusive effect); Samuel Issacharoff, *Preclusion, Due Process, and the Right to Opt Out of Class Actions*, 77 NOTRE DAME L. REV. 1057 (2002) (discussing the relationship between due-process opt-out right and preclusive effect).

111. Her proposals also do not address the problem of lack of adequate (unconflicted) representation of the interests of claimants with respect to their claims *against the released nondebtor*. *See supra* notes 105, 108-110, and accompanying text. The importance of adequate representation is intensified by the mandatory nature of nonconsensual nondebtor-release "settlements." *See* AM. L. INST., *supra* note 108, § 1.02 reporters' notes at 19.

Chapter 11 filings,[132] is causing a migration of mass tort litigation out of the tort system and into the bankruptcy system.[133] We thus see the rise in bankruptcy grifting that Simon's article rightly decries.

III. MANDATORY BANKRUPTCY AGGREGATION WITHOUT NONDEBTOR RELEASES

Simon's reluctance to embrace an outright ban on nonconsensual nondebtor releases is also motivated by her expressed fear of losing beneficial settlements if nonconsensual nondebtor releases are prohibited.[134] She holds up the Takata settlement as a model of a beneficial settlement produced by giving the settling nondebtors (Honda/Acura and Nissan/Infiniti[135]) a discharge from their Takata airbag liability in exchange for their contributions to the settlement fund.[136]

I am less optimistic about the prospects of mandatory settlements facilitating just resolutions,[137] and tend to place much more confidence in the power of claimants' exit rights to produce fair settlement terms.[138] As Professor Richard A. Nagareda trenchantly observed, "[a]bsent the ability to alter unilaterally [claimant]s' preexisting rights to sue in tort . . . settlement designers must purchase those rights by way of the benefits promised to [claimants] for remaining

132. *See* Adam J. Levitin, Purdue*'s Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. (forthcoming 2022), https://ssrn.com/abstract=3851339 [https://perma.cc/Z9F6-7G4V]; Adam J. Levitin, *Judge Shopping and the Corruption of Chapter 11* (Georgetown Univ. L. Ctr., Working Paper, Sept. 3, 2021), https://ssrn.com/abstract=3900758 [https://perma.cc/2NKQ-RFWA].

133. *See* Gluck & Burch, *supra* note 105, at 47-51 (noting that "bankruptcy court has emerged as an alternative centralizing federal court"); Patterson v. Mahwah Bergen Retail Grp., No. 21cv167, 2022 WL 135398, at *2 (E.D. Va. Jan. 13, 2022) (noting that the fact that "the Bankruptcy Court for the Richmond Division of this district regularly approves third-party releases" is a "practice [that] contributes to major companies . . . using the permissive venue provisions of the Bankruptcy Code to file for bankruptcy here").

134. *See* Simon, *supra* note 1, at 1205 ("Without the possibility of channeling or releasing claims, many nondebtor companies and individuals would withhold significant contributions that benefit claimants.").

135. *See* TAKATA AIRBAG TORT COMPENSATION TRUST FUND, http://www.takataairbaginjurytrust.com [https://perma.cc/K45Q-T26M].

136. *See* Simon, *supra* note 1, at 1205. Although she also acknowledges that the Takata settlement is aberrational and the circumstances producing it were unique. *Id.* at 1182-83.

137. And that is especially so when no serious attention is paid to separate (unconflicted) representation of creditors' distinct interests regarding their claims *against the released nondebtor*. *See supra* notes 105, 111, and accompanying text.

138. *See* John C. Coffee, *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370, 417-28 (2000); Samuel Issacharoff, *Governance and Legitimacy in the Law of Class Actions*, 1999 SUP. CT. REV. 337, 367-70.

in the settlement. [Claimant]s' preexisting rights to sue truly must be purchased rather than simply appropriated."[139] Preserving claimants' right to agree (or not) to participate in a proposed settlement, therefore, "furnish[es] a kind of market test of a settlement's fairness and adequacy, particularly of the specific compensation offers that will be made under the settlement."[140] And conjecture regarding released nondebtors' willingness to pay plaintiffs a "peace bonus" in excess of the aggregate sum they would pay without a nondebtor release is just that—unverified (and perhaps unverifiable) speculation. It seems just as, if not more, likely that any value created by a nonconsensual nondebtor release is captured entirely by the released nondebtors and the lead plaintiffs' lawyers who negotiate the nondebtor-release deal.[141]

139. NAGAREDA, *supra* note 102, at 158-59; *see id.* at 121, 136.

140. Peter H. Schuck, *Mass Torts: An Institutional Evolutionist Perspective*, 80 CORNELL L. REV. 941, 964 (1995); *see also* BURCH, *supra* note 105, at 205, 212 ("If a mass exodus occurs after a global deal, that can signal that something is amiss. . . . The more [claimants] vote with their feet, the stronger the message becomes that the deal is unattractive."); Coffee, *supra* note 138, at 424 (arguing that "[i]f plaintiffs' counsel and defendants have struck a 'sweetheart' deal that shortchanges" claimants, the best remedy is "to invite [claimants] to 'vote with their feet'"). And in that regard, I would note that the mandatory nondebtor settlements in Takata did not actually provide for "full payment" of all released nondebtors' liability to every individual claimant, as ultimately determined through the claims resolution process. The nonconsensual nondebtor releases for Honda/Acura and Nissan/Infiniti gave them immunity from any liability for punitive damages. *See* Disclosure Statement for Third Amended Joint Chapter 11 Plan of Reorganization of TK Holdings, Inc. and Its Affiliated Debtors at 34, *In re* TK Holdings, Inc., No. 17-11375-BLS (Bankr. D. Del. Jan. 5, 2018) [hereinafter Takata Disclosure Statement], https://restructuring.primeclerk.com/takata/Home-DocketInfo?DocAttribute=3105&DocAttrName=PLANDISCLOSURESTATEMENT [https://perma.cc/DKX7-E9AA]. And in any case in which a claimant opts to litigate its compensatory damages claim to judgment in a court, that judgment is not paid immediately; it is paid over a five-year period, without interest. *Id.* at 34-35.

141. *See, e.g.*, Takata Disclosure Statement, *supra* note 140, at 36-37 (disclosing that released nondebtors will pay compensation to lead plaintiffs' counsel for "work in designing, negotiating, and implementing the Channeling Injunction and [claims resolution] trust"). As Professor Nagareda observed, "the challenge lies in lending a structure to peacemaking that affords latitude for creativity to generate value but, at the same time, inhibits plaintiffs' lawyers and defendants from largely appropriating that value for themselves." NAGAREDA, *supra* note 102, at xi; *cf.* BURCH, *supra* note 105, at 63-64 (stating, in the context of multidistrict litigation (MDL) settlements, that "the limited evidence available suggests that if these premiums exist, the gains unlocked in exchange for delivering peace may be [paid to lead plaintiffs' attorneys for] common-benefit fees—not bigger plaintiff awards"). Simon's proposed "best interests" test would require inherently uncertain (and manipulable) claim valuation estimates, which does not give me confidence that each individual nonconsenting claimant would reliably receive at least as much they would in the absence of the nondebtor release, let alone a "peace bonus," if her proposal were implemented. *See* Simon, *supra* note 1, at 1212-14. Such a purely monetary calculus also ignores the nonmonetary values that many individual claimants attach

I am also more sanguine about the prospects for aggregate bankruptcy settlements with nondebtors, even if *mandatory* settlements via nondebtor release go away. Part of the rhetorical power of bankruptcy's necessity fiction is creating the false impression that nondebtors simply will not settle without nonconsensual discharge of all their liability. Indeed, as Professors Howard M. Erichson and Benjamin C. Zipursky have pointed out, a similar non sequitur pervades discussions of mass tort resolutions generally: "[O]ne sees a conflation of the *desire* for closure and the *need* for closure, a merger of ideas that occurs even more easily when one party takes the [negotiating] stance that it needs closure."[142] Of course, the forces that make aggregate settlements beneficial for plaintiffs (or their lawyers), defendants, and the judiciary will not suddenly disappear in a world without nonconsensual nondebtor releases.[143] Rather, aggregation will be achieved through other mechanisms, just as the decline of class-action aggregation and mandatory class-action settlements of mass torts in the wake of *Amchem Products, Inc. v. Windsor*[144] and *Ortiz v. Fibreboard Corp.*[145] (and then *Wal-Mart Stores, Inc. v. Dukes*[146]) led to the rise of the so-called quasi-class action through multidistrict litigation (MDL) consolidations.[147]

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to their "day in court." *See* BURCH, *supra* note 105, at 31-34, 201-04. Such nonmonetary values, however, are fully protected by assigning individual claimants a "property" right in their individual causes of action, which (not coincidentally) is what due process jurisprudence does. *See* Michael I. Krauss, *Property Rules vs. Liability Rules*, *in* 2 ENCYCLOPEDIA OF LAW AND ECONOMICS § 3800, at 788-90 (Boudewijn Bouckaert & Gerrit De Geest eds., 2000); *supra* notes 103, 107, and accompanying text.

142. Howard M. Erichson & Benjamin C. Zipursky, *Consent Versus Closure*, 96 CORNELL L. REV. 265, 319 (2011). "The question is not, however, whether [certain] participants *want* closure—of course they do. The question is whether closure, or a very high level of comprehensiveness in settlement, is *needed* . . . from a social perspective." *Id.* "Any adequate evaluation of the comparative value of a comprehensive settlement must include broad considerations that scholars have not even begun to address," particularly if one adopts the extreme position necessary to sustain nonconsensual nondebtor releases—"that closure trumps consent." *Id.* at 320.

143. *See* BURCH, *supra* note 105, at 24-30; Howard M. Erichson, *A Typology of Aggregate Settlements*, 80 NOTRE DAME L. REV. 1769, 1771-80 (2005); Samuel Issacharoff & John Fabian Witt, *The Inevitability of Aggregate Settlement: An Institutional Account of American Tort Law*, 57 VAND. L. REV. 1571, 1574 (2004) ("Indeed, since the very beginnings of U.S. tort law, a variety of aggregate settlement institutions have powerfully shaped the resolution of particular cases in some of the most important fields of tort practice.").

144. 521 U.S. 591 (1997).

145. 527 U.S. 815 (1999).

146. 564 U.S. 338 (2011).

147. *See* Andrew D. Bradt, *Something Less and Something More: MDL's Roots as a Class Action Alternative*, 165 U. PA. L. REV. 1711, 1711-12, 1714-15 (2017); Troy A. McKenzie, *Toward a Bankruptcy Model for Nonclass Aggregate Litigation*, 87 N.Y.U. L. REV. 960, 965-86 (2012); Edward F. Sherman, *The MDL Model for Resolving Complex Litigation If a Class Action Is Not Possible*, 82 TUL.

The most important element of any judicial process that can facilitate comprehensive aggregate resolutions is getting all claims into one court, which can then bring to bear the full range of judicial-management techniques for producing efficient, fair, and comprehensive resolutions.[148] In that regard, there is tremendous untapped potential for mandatory bankruptcy *consolidation* of tort victims' claims against both debtors and nondebtors to replace the bankruptcy grifter system of mandatory bankruptcy *settlements* through nonconsensual nondebtor releases. And the essential architecture for such mandatory consolidation already exists in the bankruptcy jurisdiction, removal, and venue provisions of the Judicial Code.

A. Tort Victims' Claims Against the Debtor

With respect to creditors' claims against bankruptcy debtors, including the disputed, unliquidated claims of tort victims, bankruptcy is a powerful aggregation device. Many components work together to produce bankruptcy's immense aggregation power. At the heart of it is bankruptcy's extremely broad definition of the bankruptcy "claims" that are eligible to receive a distribution from the debtor's bankruptcy estate,[149] which expressly include not only "disputed" and "unliquidated" tort claims, but also the "contingent" claims[150] of future claimants who have not yet been (but will be) injured from the debtor's prebankruptcy conduct.[151]

L. REV. 2205, 2205-09 (2008); Charles Silver & Geoffrey P. Miller, *The Quasi-Class Action Method of Managing Multi-District Litigations: Problems and a Proposal*, 63 VAND. L. REV. 107, 113-14 (2010).

148. The state of the art for such techniques is helpfully compiled by the Federal Judicial Center in its *Manual for Complex Litigation*, now in its fourth edition. FED. JUD. CTR., MANUAL FOR COMPLEX LITIGATION (4th ed. 2004). For a concise and scholarly overview, see TIDMARSH & TRANGSRUD, *supra* note 11, at 289-455. For a compilation of best judicial practices in mass tort bankruptcies, see S. ELIZABETH GIBSON, JUDICIAL MANAGEMENT OF MASS TORT BANKRUPTCY CASES (2005).

149. A debtor's bankruptcy estate is comprised, inter alia, of "all legal or equitable interests of the debtor in property as of the commencement of the case," as well as "[a]ny interest in property that the estate acquires after the commencement of the case," such as through the debtor's postpetition business operations, and until confirmation of a plan of reorganization, which "vests all of the property of the estate in the [reorganized] debtor." 11 U.S.C. §§ 541(a)(1), (7), 1141(b) (2018).

150. 11 U.S.C. § 101(5)(A) (2018).

151. Binding such unknown, uninjured future claimants to bankruptcy proceedings in which they cannot meaningfully participate obviously raises many difficult due process issues. Due process, though, is not an insuperable obstacle if, *inter alia*, an adequate fiduciary representative is appointed to represent the interests of future claimants. *See* TABB & BRUBAKER, *supra* note

Bankruptcy's statutory automatic stay immediately enjoins assertion of any "claim" against the debtor outside of the bankruptcy court.[152] This leaves filing a "proof of claim" against the debtor's bankruptcy estate in the bankruptcy court in which the debtor's bankruptcy case is pending as creditors' only recourse with respect to their claims against the debtor.[153] Confirmation of a plan of reorganization establishes the aggregate distribution "fund" available to pay each class of creditor claims.[154] Each individual creditor's pro rata distribution from that "fund" (which is typically a less than payment-in-full distribution for general unsecured creditors such as tort victims) is then determined by the claims "allowance" process.[155]

The plan of reorganization may well establish various alternative-dispute-resolution processes for voluntary settlement of disputed claims.[156] But the Bankruptcy Code also provides creditors recourse to a judicial claims allowance determination by the bankruptcy judge, in a "summary" proceeding without a jury.[157] In the case of personal injury and wrongful death claims, however, the tort victim has a statutory right to a jury trial in a federal district court.[158]

53, at 937-70. *See generally* Ralph Brubaker, *Back to the Future Claim: Due Process In and Beyond the Mass Tort Reorganization (Part I)*, 34 BANKR. L. LETTER, no. 11, Nov. 2014 (formulating a comprehensive framework for analyzing future claimants' due-process rights in bankruptcy); Ralph Brubaker, *Back to the Future Claim: Due Process In and Beyond the Mass Tort Reorganization (Part II)*, 35 BANKR. L. LETTER, no. 1, Jan. 2015 [hereinafter Brubaker, *Future Claim II*] (same).

152. 11 U.S.C. § 362(a) (2018).

153. *See id.* § 501(a).

154. *See* Brubaker, *supra* note 3, at 968-69; Brubaker, *Corporate Discharge Exceptions*, *supra* note 98, at 761.

155. *See* TABB, *supra* note 59, § 7.1, at 636, 639, § 7.26, at 724.

156. For further discussion, see S. ELIZABETH GIBSON, CASE STUDIES OF MASS TORT LIMITED FUND CLASS ACTION SETTLEMENTS & BANKRUPTCY REORGANIZATIONS (2000), which provides a detailed description and analysis of such claims resolution facilities in mass tort bankruptcy cases, as compared to those produced by pre-*Ortiz* mandatory class settlements. *See also* S. Todd Brown, *Bankruptcy Trusts, Transparency and the Future of Asbestos Compensation*, 23 WIDENER L.J. 299 (2013) (examining the bankruptcy trust system as part of the broader asbestos personal-injury compensation framework). For a revealing and insightful analysis of the claims resolution facilities under MDL settlements, see BURCH, *supra* note 105, at 134-67. For general background on claims resolution facilities, see Francis E. McGovern, *The What and Why of Claims Resolution Facilities*, 57 STAN. L. REV. 1361 (2005).

157. *See* 11 U.S.C. § 502 (2018); 28 U.S.C. § 157(b)(1), (2)(B) (2018); Katchen v. Landy, 382 U.S. 323, 336-37 (1966). The "summary" label is a reference to the traditional process, inherited from English bankruptcy practice, of so-called summary proceedings in equity before bankruptcy commissioners appointed by the Lord Chancellor. *See* Ralph Brubaker, *Justice Story, Bankruptcy Injunctions, and the Anti-Injunction Act of 1793*, 92 TEX. L. REV. SEE ALSO 67, 76 (2014); *see also* Brubaker, *"Summary" Theory*, *supra* note 53, at 122-26.

158. *See* 28 U.S.C. §§ 157(b)(2)(B), (O), 157(b)(5), 1411(a) (2018).

The ultimate aggregative power of bankruptcy comes from the fact that confirmation of a plan of reorganization not only fixes creditors' distribution rights from the debtor's bankruptcy estate, it also "discharges" the debtor from any prebankruptcy claim, "whether or not a proof of the claim . . . is filed" or "such claim is allowed."[159] All creditors (broadly defined to include even future, unknown, uninjured claimants) are thus bound to the distribution rights established by the confirmed plan of reorganization, whether or not they file a claim or otherwise appear and participate in the bankruptcy proceedings—and they cannot thereafter assert their discharged claims against the debtor or the debtor's property.[160] Indeed, another automatic statutory injunction, the discharge injunction, enjoins creditors from doing so.[161] And the bankruptcy court's territorial jurisdiction to bind creditors extends to any and all who have "minimum contacts" with the United States of America.[162]

That is bankruptcy's "special" statutory preclusion design to which the Supreme Court has alluded, most recently in *Taylor v. Sturgell*.[163] Like class actions,[164] that preclusion mechanism is how bankruptcy effectuates its powerful aggregation of all prebankruptcy claims against a bankruptcy debtor of every stripe, including disputed tort claims.[165] Indeed, bankruptcy claims aggregation, which is a form of mandatory aggregation by preclusion, functions in precisely

159. 11 U.S.C. § 1141(d)(1)(A)(i)-(ii) (2018).

160. Bankruptcy's statutory free-and-clear sale and vesting provisions essentially "discharge" the debtor's property (and bankruptcy purchasers of the debtor's property) from any continuing liability on prebankruptcy claims also. *See id.* §§ 363(f), 1141(c); Brubaker, *Corporate Discharge Exceptions*, *supra* note 98, at 771.

161. 11 U.S.C. § 524(a)(2) (2018).

162. Nationwide service of process is available in all federal bankruptcy proceedings. *See* FED. R. BANKR. P. 7004(d), 9014(b). "With nationwide service, the forum is the United States. So minimum contacts with the United States (Fifth Amendment due process) suffice; minimum contacts with a particular state (Fourteenth Amendment due process) are beside the point." Double Eagle Energy Servs., LLC v. MarkWest Utica EMG, LLC, 936 F.3d 260, 264 (5th Cir. 2019).

163. 553 U.S. 880, 895 (2008) (quoting Martin v. Wilks, 490 U.S. 755, 762 n.2 (1989) (stating that "where a special remedial scheme exists expressly foreclosing successive litigation by nonlitigants, as for example in bankruptcy or probate, legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process")).

164. *See* NAGAREDA, *supra* note 102, at 9, 71-73; TIDMARSH & TRANGSRUD, *supra* note 11, at 139 (pointing out that "the class action's preclusive effect on the claims of class members is the crux of why class actions are . . . so powerful").

165. "When the bankruptcy court confirms a plan, its terms become binding on debtor and creditor alike. Confirmation has preclusive effect, foreclosing relitigation of 'any issue actually litigated by the parties and any issue necessarily determined by the confirmation order.'" Bullard v. Blue Hills Bank, 575 U.S. 496, 502 (2015) (quoting 8 COLLIER ON BANKRUPTCY ¶ 1327.02[1][c], at 1327-6 (16th ed. 2014)).

the same manner as settlement of a mandatory class action in achieving *universal* aggregation.[166]

In combination, those are the means by which bankruptcy "channels" creditors' claims: (1) out of the various otherwise available nonbankruptcy state and federal fora and into one court, the federal bankruptcy court presiding over the debtor's bankruptcy case, and (2) away from the debtor and toward and against only the "fund/s" the plan establishes for payment of creditors' claims.[167]

B. Tort Victims' Related Claims Against Nondebtors

1. Mandatory, Universal Settlement via Nondebtor Release

By replicating the effects of the bankruptcy discharge and discharge injunction for creditors' claims against solvent nondebtors, nonconsensual nondebtor releases and permanent injunctions allow nondebtors to get in on bankruptcy's mandatory, universal aggregation by preclusion.[168] Most importantly from the perspective of both nondebtors and tort victims, that mandatory, universal aggregation by preclusion puts a hard cap on released nondebtors' liability exposure at the amount of the "substantial assets [contributed] to the reorganization."[169] But that criterion for approval of a nondebtor release is extremely (and troublingly) vague. Indeed, "nothing in the process by which releases are approved requires contributions by released nondebtors to approximate the value

166. *See* Brubaker, *Future Claim II*, *supra* note 151, at 11 (noting that "a class action settlement is extremely analogous to the binding distribution scheme effectuated by a confirmed plan of reorganization in Chapter 11, complete with a preliminary injunction analogous to bankruptcy's automatic stay, an anti-suit injunction upon final approval of the settlement analogous to bankruptcy's discharge injunction, and in the case of the limited-fund [mandatory] class action at issue in *Ortiz*, no ability whatsoever for individual claimants to opt-out of the settlement, which is of course precisely the function of the bankruptcy discharge effectuated by confirmation of a plan of reorganization" (footnotes omitted)).

167. *See supra* note 11.

168. *See* Travelers Indem. Co. v. Bailey, 557 U.S. 137, 151-54 (2009) (confirmation of plan containing nonconsenual nondebtor release precludes subsequent suit on released claims); Stoll v. Gottlieb, 305 U.S. 165 (1938) (same); Brubaker, *supra* note 6, at 9-11. "Indeed, that is the entire purpose and function of a nonconsensual non-debtor 'release'—to forever and definitively extinguish and bar, by final judgment of a federal court, any collateral suit on the third-party non-debtor claims 'released' thereby." *Id.* at 11.

169. Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002).

of the released claims"[170] nor any other meaningful review of the structural or substantive fairness of the nondebtor release deal.[171]

In the taxonomy of aggregation devices, mandatory universal aggregation by preclusion is the most powerful and thereby carries the most potential to ride roughshod over individual claimants' substantive, procedural, and constitutional rights, as nonconsensual nondebtor releases and the resulting bankruptcy grifter phenomenon amply illustrate. But a range of other aggregation mechanisms exist.[172] And with respect to the third-party nondebtor tort claims resolved via nondebtor release (i.e., mandatory *settlement*), bankruptcy contains another very powerful aggregation structure for mandatory *consolidation*.

2. *Mandatory, Universal Consolidation of Personal Injury Claims*

The essential architecture for mandatory consolidation of mass tort claims against nondebtors is already present in existing bankruptcy law. Section 157(b)(5) of the Judicial Code provides for single-district consolidation of all creditors' related personal injury claims against a nondebtor, in a manner similar to an MDL consolidation.[173] But a § 157(b)(5) bankruptcy consolidation of personal injury claims is even more powerful than an MDL consolidation in two significant respects. First, unlike an MDL consolidation, which can only consolidate cases pending in the federal courts, a § 157(b)(5) bankruptcy consolidation can centralize claims pending in both federal and state courts, through the broader removal power available under the bankruptcy removal statute.[174] Second, unlike an MDL consolidation, which is solely "for coordinated or consolidated pretrial proceedings,"[175] a § 157(b)(5) bankruptcy consolidation is for *all* purposes, including trial in a federal district court.

170. Brubaker, *supra* note 3, at 992 (typeface altered). Curing that deficiency is the principal object of Simon's proposed reforms of nondebtor-release practice, particularly her proposed "best interests" requirement. *See* Simon, *supra* note 1, at 1212-14; *supra* notes 95-97, 141, and accompanying text.

171. *See* Brubaker, *supra* note 3, at 977-78.

172. For an excellent survey of the landscape, see TIDMARSH & TRANGSRUD, *supra* note 11, at 39-256.

173. 28 U.S.C. § 157(b)(5) (2018). For other discussions of § 157(b)(5) as an aggregation device, see TIDMARSH & TRANGSRUD, *supra* note 11, at 234-35, 239-42; TABB & BRUBAKER, *supra* note 48, at 866-76; Douglas G. Smith, *Resolution of Mass Tort Claims in the Bankruptcy System*, 41 U.C. DAVIS L. REV. 1613, 1649-62 (2008); Georgene Vairo, *Mass Tort Bankruptcies: The Who, the Why, and the How*, 78 AM. BANKR. L.J. 93, 121-25 (2004).

174. 28 U.S.C. § 1452(a) (2018).

175. *Id.* § 1407(a).

The consolidation power of § 157(b)(5) for tort victims' claims against nondebtors starts with the breadth of federal bankruptcy jurisdiction, which as previously noted,[176] extends to creditors' third-party claims against nondebtors that are "related to" the debtor's bankruptcy case.[177] For any such third-party "related to" claim pending in state court when the debtor files bankruptcy (or filed in state court thereafter), the bankruptcy removal statute provides that either party may remove that "claim or cause of action" into federal court.[178] Bankruptcy removal, therefore, is a more surgical removal of only a "claim or cause of action" within a pending civil action, rather than the entire "civil action," which is the object of a general civil removal.[179] Moreover, bankruptcy removal is at the instance of only one of the parties to an individual "claim or cause of action."[180] Consequently, it is impossible for an opposing party to frustrate bankruptcy removal through the kind of jurisdictional and removal spoilers that can prevent general civil removal of state-law tort claims.[181]

For example, imagine hundreds or thousands of personal injury suits against two alleged joint tortfeasors (*D* and *ND*) are pending in state and federal courts all over the country, and one of those alleged joint tortfeasors (*D*) files Chapter 11. All the tort claims against *D* now become subject to the mandatory, universal bankruptcy aggregation process previously discussed.[182] In addition, though, as long as the pending tort claims against *ND* are "related to" *D*'s bankruptcy case, *ND* can immediately remove all of those pending tort claims from state court into federal court,[183] and any such claims that are subsequently filed in state court will likewise be immediately removable.[184]

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176. *See supra* notes 27-28 and accompanying text.

177. 28 U.S.C. § 1334(b) (2018).

178. *Id.* § 1452(a).

179. *See id.* § 1441(a).

180. *See id.* § 1452(a).

181. For example, if a plaintiff sues on only state-law claims and names even one nondiverse defendant, then there is no basis for federal jurisdiction and, thus, no basis for removal under 28 U.S.C. § 1441(a) (2018). Even if a plaintiff sues only diverse defendants on only state-law claims, if the suit is in the state of at least one defendant's citizenship, then § 1441(b)(2) precludes removal based on diversity jurisdiction. And even if there is a good basis for federal jurisdiction and removal, all defendants must consent to a removal under § 1441(a). Gamesmanship to prevent removal under the special class- and mass-action removal statutes is also possible. *See* TIDMARSH & TRANGSRUD, *supra* note 11, at 93-96.

182. *See supra* Section III.A.

183. *See* FED. R. BANKR. P. 9027(a)(2).

184. *See id.* 9027(a)(3).

Like general civil removal, bankruptcy removal is "to the district court for the district where [the removed claim was] pending."[185] *ND*'s bankruptcy removal, therefore, places all of the tort claims against it in federal court, but scattered across federal districts all over the country. This is where § 157(b)(5) becomes important.

Section 157(b)(5) provides that a district-court judge in the district where *D*'s bankruptcy case is pending (the so-called "home court" district) "shall order that personal injury tort and wrongful death claims shall be tried in the district court in which the bankruptcy case is pending, or in the district court in which the claim arose."[186] After (or in conjunction with) removing all of the "related to" tort claims to federal court, therefore, *ND* can file a § 157(b)(5) motion in the district court in *D*'s home-court bankruptcy district, requesting that all of the tort claims against it in federal court (those that were just removed, those that were previously pending, and those that might subsequently be filed or removed) be transferred to *D*'s home-court bankruptcy district for consolidation there.[187]

Notice, then, that § 157(b)(5) gives one district-court judge in *D*'s home-court bankruptcy district a discretionary power, much like the MDL statute gives to the Judicial Panel on Multidistrict Litigation (JPMDL), to impose mandatory

185. 28 U.S.C. § 1452(a) (2018).

186. *Id.* § 157(b)(5). The principal purpose and effect of § 157(b)(5) and its companion personal injury and wrongful death (PIWD) claim provisions enacted in 1984, 28 U.S.C. §§ 157(b)(2)(B) & (O), (b)(4), (b)(5), 1411(a) (2018), are directed at claims against the debtor's estate, discussed *supra* Section III.A. *See* Ishaq Kundawala, *Unveiling the Mystery, History, and Problems Associated with the Jurisdictional Limitations of Bankruptcy Courts over Personal Injury Tort and Wrongful Death Claims*, 42 MCGEORGE L. REV. 739, 756-58 (2011). With respect to creditors' PIWD claims against the estate, those provisions change (1) the allocation of adjudicatory power as between Article III district courts and their non-Article III bankruptcy court units, (2) creditors' jury trial rights, and (3) the presumptive centralized venue for all claims allowance proceedings only in the home bankruptcy-court district. The PIWD claim provisions (1) take away bankruptcy courts' power to finally adjudicate PIWD claims against the estate (2) without a jury, by giving PIWD creditors a right to a jury trial in a federal district court in their clams allowance proceedings. In addition, (3), § 157(b)(5) explicitly provides an alternative venue for claims allowance proceedings and, thus, has a *de*centralization purpose and effect as applied to creditors' PIWD claims against the debtor's estate. As the Sixth Circuit held in the *Dow Corning* case, though, by its terms § 157(b)(5) is *not* limited to PIWD claims against the debtor's estate, and thus, at least with respect to "related to" PIWD claims (i.e., *not* against the debtor's bankruptcy estate), § 157(b)(5) can (somewhat incongruously) be construed and applied in furtherance of a *centralization* objective. Lindsey v. O'Brien, Tanski, Tanzer & Young Health Care Providers of Conn. (*In re* Dow Corning Corp.), 86 F.3d 482, 495-97 (6th Cir. 1996); *see* TABB & BRUBAKER, *supra* note 53, at 913-14.

187. I use the term consolidation herein loosely to mean the equivalent of centralization in one district, whether or not there is a formal consolidation of related claims pursuant to FED. R. CIV. P. 42(a).

consolidation in one federal district of all of the "related to" tort claims against *ND*. And just like the tort claims against bankruptcy debtor *D*, which are subject to bankruptcy's universal, mandatory aggregation process,[188] a § 157(b)(5) mandatory consolidation of the tort claims against *ND* can also be universal, encompassing any and all of the "related to" tort claims that have been or will be filed against *ND* in any court in the country.

Such a § 157(b)(5) consolidation can not only capture the efficiencies and settlement facilitation potential from consolidating all of the tort claims against *ND* in one court, but also enable the *joinder* efficiencies and settlement facilitation from placing the claims of all victims whose claims are against both *D* and *ND* in the same court.[189] And each and every victim will have the right to a jury trial in a federal district court in *D*'s home-court bankruptcy district for both of its claims—its proof of claim against bankruptcy debtor *D* and its third-party "related to" claim against nondebtor *ND*.[190]

To say that a mandatory, universal consolidation of all "related to" claims against *ND can* occur via § 157(b)(5) is, of course, not to say that the district court *should* order consolidation of those claims in *D*'s bankruptcy case. But the district court would have at its disposal the same kinds of considerations the JPMDL weighs in deciding whether to order an MDL consolidation.[191] Moreover, if the district court decides that a § 157(b)(5) consolidation is not appropriate, the district court can also order a mandatory, universal *remand* of all removed state-law claims under bankruptcy's unique discretionary abstention and remand provisions.[192]

188. *See supra* Section III.A.

189. *See* AM. L. INST., *supra* note 108, § 1.03 & cmts. b-c; Robert G. Bone, *Revisiting the Policy Case for Supplemental Jurisdiction*, 74 IND. L.J. 139, 140 & n.7, 143, 149 (1998).

190. *See* 28 U.S.C. §§ 157(b)(5), 1411(a) (2018); *supra* note 186 and accompanying text.

191. *See* John G. Heyburn II, *A View from the Panel: Part of the Solution*, 82 TUL. L. REV. 2225 (2008); Richard L. Marcus, *Cure-All for an Era of Dispersed Litigation? Toward a Maximalist Use of the Multidistrict Litigation Panel's Transfer Power*, 82 TUL. L. REV. 2245 (2008).

192. "[A] Section 157(b)(5) motion 'requires an abstention analysis.'" Lindsey v. O'Brien, Tanski, Tanzer & Young Health Care Providers of Conn. (*In re* Dow Corning Corp.), 86 F.3d 482, 497 (6th Cir. 1996) (quoting Coker v. Pan Am. World Airways Inc. (*In re* Pan Am Corp.), 950 F.2d 839, 844 (2d Cir. 1991)). The bankruptcy jurisdiction statute contains a very broad, discretionary authority to abstain from hearing any claim within federal bankruptcy jurisdiction "in the interest of justice, or in the interest of comity with State courts or respect for State law." 28 U.S.C. § 1334(c)(1) (2018). Likewise, the bankruptcy removal statute provides that a removed claim or cause of action may be remanded "on any equitable ground." *Id.* § 1452(b). "Codification of a discretionary abstention power [in 1978] acknowledged (and likely expanded) an existing body of Supreme Court precedent recognizing the propriety of a federal bankruptcy court staying its hand, in cases such as *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940)." Brubaker, *supra* note 28, at 798 n.204; *see id.* at 840 & n.360 (summarizing

There is also tremendous underexplored potential in hybrid approaches, similar to the originally intended operation of the MDL statute, that exploit the efficiency and settlement advantages of pretrial centralization, but that permit any individual trials to occur in victims' local communities.[193] As Professor Nagareda insightfully recognized, "aggregation in a world in which the modern class action does not, and will not, realistically shoulder the entire regulatory load" requires "*hybridization*—the combination of individual actions with some manner of centralizing mechanism" that combines "traditional litigation features with aggregate ones."[194] The flexible, discretionary nature of both § 157(b)(5)[195] and the bankruptcy abstention and remand provisions[196] can accommodate all manner of such creative hybrid-resolution models.

IV. THE ROLE OF THE SUPREME COURT

Simon envisions reforming nonconsensual nondebtor-release practice. My vision is for mandatory, universal consolidation to replace mandatory, universal settlement via nondebtor release. Can either prospect be realized?

Simon's reforms would likely depend on some combination of judicial or congressional intervention. Given our cumulative experience with nondebtor releases, I am pessimistic about the likelihood of the courts "organically"[197] reforming nondebtor-release practice, particularly given the forum-shopping dynamic that will likely continue to fuel and accelerate a race to the bottom on

that body of Supreme Court case law). The closest analogy to bankruptcy's discretionary abstention and remand statutes is codification in the general supplemental jurisdiction statute, 28 U.S.C. § 1367(c) (2018), of the discretionary power to decline to exercise supplemental jurisdiction. *See* Brubaker, *supra* note 28, at 863-65 & n.444.

193. *See* BURCH, *supra* note 105, at 162-66, 210-14.

194. Richard A. Nagareda, *Embedded Aggregation in Civil Litigation*, 95 CORNELL L. REV. 1105, 1113-14, 1171 (2010).

195. Section 157(b)(5) permits the home-court district judge to set the venue of a personal injury or wrongful death claim in the home-court district "or in the district court in the district in which the claim arose." 28 U.S.C. § 157(b)(5) (2018). Nothing in § 157(b)(5) would preclude the home-court district court from making an initial centralization transfer of all tort claims against *ND* to the home-court district of *D*'s pending bankruptcy case and then later transferring individual tort claims to the districts where the claims arose for trial.

196. There are no time limits for discretionary bankruptcy abstention or remand. *See, e.g.*, FED. R. BANKR. P. 9027(d). Thus, even after a § 157(b)(5) centralization of all tort claims against *ND* in the home-court district of *D*'s pending bankruptcy case, the home-court district court could permit trials of individual tort claims against *ND* to take place in the (state or federal) courts in which the claims were originally filed, via remand or abstention.

197. Simon, *supra* note 1, at 1215.

nondebtor releases.[198] As for congressional action, I fear that corporate interests, and even certain powerful segments of the plaintiffs' and bankruptcy bars, could frustrate any meaningful legislative reforms.[199]

My proposal's comparative implementation advantage is that its actualization resides within the authority of one actor—the Supreme Court—in fulfilling its conventional function of resolving circuit splits. Nonconsensual nondebtor-release practice is illegitimate and unconstitutional substantive lawmaking by the federal courts, which the Supreme Court should put an end to. And in navigating the innate mass tort tension between individual victims' rights and autonomy, on the one hand, and the relentless forces of aggregation, on the other, the Supreme Court appears to be the only meaningful watchdog that can ensure structural protections for individual victims—at least from the most egregious systemic abuses, which nondebtor releases are.[200]

Were the Supreme Court to prohibit nonconsensual nondebtor releases, there are credible indications that § 157(b)(5) bankruptcy consolidations would fill the space created by prohibition of nonconsensual nondebtor releases. Even in a world in which nonconsensual nondebtor releases are permissible, codefendants have on occasion, with mixed results, attempted the bankruptcy removal and consolidation strategy outlined in Part III.[201]

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198. *See supra* notes 128, 132, 133, and accompanying text.

199. Moreover, recent legislative activity indicates that if Congress were to address nonconsensual nondebtor releases, outright prohibition may be just as (if not more) likely than reforms of the kind Simon proposes. *See* S. 2497, 117th Cong. (2021) (proposing 11 U.S.C. § 113(a) to prohibit nonconsensual nondebtor releases and permanent injunctions); H.R. 4777, 117th Cong. (2021) (same); Jonathan Randles, *Elizabeth Warren Targets Sacklers' Legal Protection in Purdue Bankruptcy*, WALL ST. J. (July 23, 2021), https://www.wsj.com/articles/elizabeth-warren-targets-sacklers-lawsuit-exemptions-in-purdue-bankruptcy-11627041600 [https://perma.cc/MC9H-DHD8].

200. And that view of the Supreme Court's institutional role in mass torts may help explain the *Amchem* and *Ortiz* decisions. *See* Coffee, *supra* note 138, at 437 ("Indeed, the goal of [claimant] autonomy . . . seems to be the one thread that unites *Amchem* and *Ortiz* with earlier Supreme Court decisions such as *Hansberry v. Lee* and *Martin v. Wilks*." (footnotes omitted)); *cf.* Thomas D. Morgan, *Client Representation vs. Case Administration: The ALI Looks at Legal Ethics Issues in Aggregate Settlements*, 79 GEO. WASH. L. REV. 734, 741 (2011) ("The only people with a powerful bias toward particularized representation, in short, are the clients whose interests the law purports to protect.").

201. *See, e.g.*, *In re* Fed.-Mogul Glob., Inc., 300 F.3d 368 (3d Cir. 2002) (affirming the denial of a § 157(b)(5) consolidation of break-pad claims against automotive manufacturers in bankruptcy case of brake-pad manufacturer); Lindsey v. Dow Chem. Co. (*In re* Dow Corning Corp.), 113 F.3d 565 (6th Cir. 1997) (ordering a § 157(b)(5) consolidation in Dow Corning's bankruptcy case of breast-implant claims against Dow Chemical and Corning Inc., corporate parents of breast-implant manufacturer Dow Corning); *In re* Imerys Talc Am., Inc., No. 19-mc-103, 2019 WL 3253366 (D. Del. July 19, 2019) (denying a § 157(b)(5) consolidation of talc

The only significant obstacle to fully effective use of § 157(b)(5) consolidations is the circuits' disagreement over the scope of third-party "related to" bankruptcy jurisdiction, which was consciously designed to be as broad as the Constitution permits.[202] Here, too, the Supreme Court can and should resolve this critical issue of federal jurisdiction, whose importance transcends mass tort bankruptcies and pervades the entirety of bankruptcy courts' dockets,[203] including even the most prosaic consumer bankruptcy cases.[204]

The vast and sprawling case law regarding the scope of third-party "related to" bankruptcy jurisdiction is in a state of utter and dizzying disarray, all of which can best be understood and explained through one straightforward, central question: is third-party "related to" bankruptcy jurisdiction simply a grant of conventional transactional supplemental jurisdiction? If so,[205] then all the confusion surrounding third-party "related to" bankruptcy jurisdiction vanishes, and a nightmarishly unwieldy and problematic corner of federal jurisdiction is greatly simplified and modernized. If not, then there is seemingly no escape from

claims against Johnson & Johnson (J&J) in the bankruptcy case of J&J's talc supplier); *see* TABB & BRUBAKER, *supra* note 53, at 905-19.

202. *See* Brubaker, *supra* note 28, at 793-99.

203. Most significantly, the confusion regarding the scope of third-party "related to" bankruptcy jurisdiction frustrates the full implementation of modern joinder devices, embodied in both the Federal and Bankruptcy Rules of Civil Procedure, in bankruptcy litigation. *See* Brubaker, *supra* note 51, at 1-9; Ralph Brubaker, *One Hundred Years of Federal Bankruptcy Law and Still Clinging to an* In Rem *Model of Bankruptcy Jurisdiction*, 15 EMORY BANKR. DEV. J. 261, 274-84 (1999) [hereinafter Brubaker, *One Hundred Years*]; Brubaker, *supra* note 28, at 921-40.

204. For example, the uncertainty regarding the scope of third-party "related to" bankruptcy jurisdiction bedevils a bankruptcy court's ability to liquidate and enter a money judgment on the debt of an individual (i.e., not corporate) debtor declared nondischargeable, because the court has determined, for instance, that the debtor committed fraud. *See* Ralph Brubaker, *Federal Bankruptcy Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt (Part I): A Tale of Two Seventh Circuit Decisions and Related-To Jurisdiction*, 40 BANKR. L. LETTER, no. 5, May 2020, at 1; Ralph Brubaker, *Federal Bankruptcy Jurisdiction to Enter a Money Judgment on a Nondischargeable Debt (Part II): A Tale of Two Seventh Circuit Decisions and Related-To Jurisdiction*, 40 BANKR. L. LETTER, no. 8, Aug. 2020, at 1; Brubaker, *supra* note 28, at 910-21.

205. The Second, Seventh, Ninth, and Eleventh Circuits have all indicated that third-party "related to" bankruptcy jurisdiction is a grant of transactional supplemental jurisdiction. *See* Townsquare Media, Inc. v. Brill, 652 F.3d 767, 771-72 (7th Cir. 2011); Hosp. Ventures/Lavista v. Heartwood II, LLC (*In re* Hosp. Ventures/Lavista), 265 F. App'x 779 (11th Cir. 2008), *aff'g* 358 B.R. 462, 468-81 (Bankr. N.D. Ga. 2007); Sasson v. Sokoloff (*In re* Sasson), 424 F.3d 864, 868-69 (9th Cir. 2005); Klein v. Civale & Trovato, Inc. (*In re* Lionel Corp.), 29 F.3d 88, 92 (2d Cir. 1994). Ironically, given the *Pacor* decision discussed *infra* notes 207-209 and accompanying text, even the Third Circuit has, at times, indicated that the reach of third-party "related to" bankruptcy jurisdiction is coextensive with that of the general supplemental jurisdiction statute. *See, e.g.*, Pelora v. United States, 488 F.3d 163, 172 n.8 (3d Cir. 2007).

the quagmire into which the courts have thoughtlessly stumbled by blindly following the Third Circuit's badly misguided *Pacor* decision.[206]

In the *Pacor* case, the Third Circuit assuredly declared that third-party "related to" bankruptcy jurisdiction most definitely is *not* supplemental jurisdiction.[207] But as I have explained elsewhere at length, every credible indication points to the conclusion that third-party "related to" bankruptcy jurisdiction is a statutory grant of modern transactional supplemental jurisdiction.[208] Indeed, "use of the identical term 'related to' in both [the bankruptcy jurisdiction statute] § 1334 and [the general supplemental jurisdiction statute] § 1367 . . . suggests that supplemental jurisdiction is what Congress always intended when it used that term in § 1334."[209]

If third-party "related to" jurisdiction is a grant of conventional supplemental jurisdiction, then there is federal bankruptcy jurisdiction over any third-party "claims [that] arose from the same nucleus of operative fact"[210] as a claim

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206. Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984). For a discussion of *Pacor*'s many missteps, see Brubaker, *supra* note 28, at 869-87.

207. *Pacor*, 743 F.2d at 994. For an explanation of why that was a manifestly erroneous conclusion, see Brubaker, *supra* note 28, at 878-80; and TABB & BRUBAKER, *supra* note 53, at 883-84.

208. My book-length exploration of these issues is Brubaker, *supra* note 28. For more concise treatments, see Brubaker, *supra* note 51; and Brubaker, *One Hundred Years*, *supra* note 203.

209. Pierce v. Conseco Fin. Servicing Corp. (*In re* Lockridge), 303 B.R. 449, 455 (Bankr. D. Ariz. 2003). In fact, every time "Congress has sought to expressly create supplemental jurisdiction, it has used the 'related' terminology, and to the extent that a grant of 'related' jurisdiction has a plain or ordinary meaning, it is recognized as connoting supplemental jurisdiction." Brubaker, *supra* note 28, at 862-63 (footnotes omitted); *accord Townsquare Media*, 652 F.3d at 771 ("One might think that the bankruptcy court . . . would have the same supplemental jurisdiction as the district court . . . especially since Congress has given the district courts (including therefore bankruptcy courts) jurisdiction over proceedings 'related to' bankruptcy." (citing *Sasson*, 424 F.3d at 868-69 (holding that "the bankruptcy court's '*related to*' jurisdiction also includes the district court's supplemental jurisdiction pursuant to 28 U.S.C. § 1367 'over all claims that are so *related to* claims in the action within [the court's] original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution" (emphasis added)))); Frank R. Kennedy, *The Bankruptcy Court Under the New Bankruptcy Law: Its Structure, Jurisdiction, Venue, and Procedure*, 11 ST. MARY'S L.J. 251, 285-88, 287 (1979) (executive director of the congressional commission that led to the 1978 legislation opining that the new statutory grant of "related to" jurisdiction over third-party disputes "requires a consideration of the potential reach of a concept or doctrine of ancillary [now known as supplemental] jurisdiction"); *see also* George Brody, *Frank R. Kennedy*, 82 MICH. L. REV. 189, 192 (1983) (describing Frank Kennedy's work as the executive director of the congressional commission).

210. United Mine Workers v. Gibbs, 383 U.S. 715, 728 (1966).

by or against the debtor's bankruptcy estate.[211] In my previous example, then, all of the tort claims against *ND* undoubtedly would be within "related to" bankruptcy jurisdiction, and a § 157(b)(5) bankruptcy consolidation is permissible.[212]

Crucially, this mandatory, universal consolidation of the personal injury claims against *ND* could even include any future claim of an as-yet-uninjured victim, to the extent that a future claimant's related claim against *D* is a bankruptcy "claim" within the meaning of the Bankruptcy Code, eligible for a distribution and subject to discharge (and thus mandatory, universal aggregation) in *D*'s bankruptcy case.[213] The inability to aggregate such future claims is one of the principal shortcomings of other aggregation devices.[214] But bankruptcy has the means—entirely within its existing statutory structure—to aggregate not only future claims against the debtor, but also future claims against nondebtors via § 157(b)(5).

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211. A claim by or against the federally created bankruptcy estate is a constitutional federal-question claim under the "original ingredient" or federal-entity theory of constitutional federal questions, first articulated by Chief Justice Marshall's opinion in *Osborn v. Bank of the United States*, 22 U.S. (9 Wheat.) 738, 823-26 (1824). *See* Brubaker, *One Hundred Years*, *supra* note 203, at 282-83; Brubaker, *supra* note 28, at 813-31. Thus, "the relationship between that claim and the [third-party nondebtor] claim permits the conclusion that the entire action before the court comprises but one constitutional 'case.'" *Gibbs*, 383 U.S. at 725.

212. Thus, in the 1997 *Dow Corning* case, discussed *supra* note 201, the critical prior ruling—which cleared the way for the Sixth Circuit to order a § 157(b)(5) consolidation of breast-implant claimants' third-party claims against codefendants Dow Chemical and Corning Inc. in the bankruptcy case of Dow Corning—was the Sixth Circuit's previous decision in 1996 that there was federal bankruptcy jurisdiction over those third-party nondebtor claims because they were "related to" Dow Corning's bankruptcy case. *See* Lindsey v. O'Brien, Tanski, Tanzer & Young Health Care Providers of Conn. (*In re* Dow Corning Corp.), 86 F.3d 482, 485-95 (6th Cir. 1996). The Sixth Circuit is among those courts that apply the grant of third-party "related to" bankruptcy jurisdiction in a manner that is indistinguishable from supplemental jurisdiction. *See* Brubaker, *supra* note 28, at 905-10.

213. *See supra* Section III.A. The primary stand-alone claim in an Article III constitutional category, to which a future claimant's claim against *ND* would be supplemental, could be either (1) the future claimant's subsequently filed proof of claim in *D*'s bankruptcy case, or (2) *ND*'s proof of claim filed in *D*'s bankruptcy case (even *before* the future claimant is injured) asserting a *contingent* right to indemnification or contribution from *D*. *See* Brubaker, *supra* note 28, at 875-77. To the extent that a § 157(b)(5) consolidation contemplates consolidation of even *future* tort claims against a nondebtor, due process would seem to require appointment of an adequate fiduciary representative for the claims of future claimants *against the nondebtor* in conjunction with consideration of the § 157(b)(5) consolidation motion. *See supra* notes 150-151 and accompanying text.

214. *See* AM. L. INST., *supra* note 108, § 3.10 cmt. b, at 233-34; TIDMARSH & TRANGSRUD, *supra* note 11, at 17-18, 213-15, 242-45. Indeed, "the need to fashion a binding peace for both pending claims and future ones . . . represents the central challenge in mass tort litigation generally." NAGAREDA, *supra* note 102, at 167.

Under *Pacor*'s interpretation, which concludes that third-party "related to" bankruptcy jurisdiction is not supplemental jurisdiction, the absence of any federal bankruptcy jurisdiction over the tort claims against *ND* is an absolute nonstarter for a § 157(b)(5) consolidation.[215] By correcting the severe systemic flaw that *Pacor* introduced into the critical infrastructure of federal bankruptcy jurisdiction, therefore, the Supreme Court would, in the process, also open the door to maximally effective § 157(b)(5) consolidations and aggregate settlements. Indeed, one of the prominent policy rationales for modern transactional supplemental jurisdiction is facilitating joinder of related claims in one court and, thereby, settlement of complex disputes.[216] In fact, § 157(b)(5) consolidations would be an immensely more powerful and fairer centralization process than MDL consolidations.

The comprehensiveness of a § 157(b)(5) consolidation will be particularly appealing to nondebtor defendants,[217] who would be the necessary drivers of the centralization process, through exhaustive removals and § 157(b)(5) consolidation motions. Even more importantly, § 157(b)(5) consolidations should prove more advantageous to tort claimants than MDL consolidations.

MDL consolidations are hamstrung by the inability of MDL transferee courts to try transferred cases without the consent of all parties. Moreover, remands to transferor courts for trial are exceedingly rare.[218] MDL consolidations, therefore, have become a procedure focused almost exclusively upon settlement, in which plaintiffs cannot wield their most effective settlement cudgel: a credible threat of taking cases to trial.[219] This "sharply skews the MDL bargaining process in favor of defendants."[220] A § 157(b)(5) bankruptcy consolidation, by contrast, in which

215. *See, e.g.*, *In re* Fed.-Mogul Glob., Inc., 300 F.3d 368, 379-84 (3d Cir. 2002); *In re* Imerys Talc Am., Inc., No. 19-mc-103, 2019 WL 3253366, at *2-7 (D. Del. July 19, 2019).

216. *See* Brubaker, *supra* note 28, at 906-07 & nn.571-72, 935.

217. *See* AM. L. INST., *supra* note 108, § 3.10 cmt. b, at 233; BURCH, *supra* note 105, at 26-27; Erichson, *supra* note 143, at 1775-80.

218. *See* BURCH, *supra* note 105, at 209-10 (reporting a remand rate of only three percent of the over 500,000 consolidated civil actions since JPMDL's inception in 1968). And it is not uncommon for an MDL settlement to occur without any merits-based rulings in the MDL transferee court that can clarify potential settlement values. *See id.* at 108, 110, 113-14; Gluck & Burch, *supra* note 105, at 15-16, 54-57.

219. *See* NAGAREDA, *supra* note 102, at 19-20 ("In the face of defendants' intransigence, mass tort plaintiffs' lawyers have only one real bargaining chip, but it is a big one: their power to take cases to trial."); Silver & Miller, *supra* note 147, at 123 (noting that the "standard economic model of settlement" indicates that "the weapon that pressures a defendant to pay a reasonable amount in settlement" is "the threat of forcing an exchange at a price set by a jury").

220. Delaventura v. Columbia Acorn Tr., 417 F. Supp. 147, 153-54 (D. Mass. 2006); *see also* Silver & Miller, *supra* note 147, at 123-24 ("Being stuck forever in a court that cannot preside over a trial every personal injury claimant would have a statutory right to a jury trial on their claims against *ND* in the transferee federal district court (where *D*'s bankruptcy case is pending),[221] could restore a more level playing field for both aggregate settlement negotiations with *ND* and resolution of residual "opt out" cases against *ND*.[222]

CONCLUSION

Simon's *Bankruptcy Grifters* article shines a bright and penetrating light on alarming injustices occurring through the intimidatingly complex and mysterious machinations of corporate bankruptcy proceedings. As a practical matter, the Supreme Court is the only institution that can put a stop to bankruptcy grifting, by prohibiting nonconsensual nondebtor releases. By reversing *Pacor*'s error, the Supreme Court can also pave the way for a fairer bankruptcy process for aggregate resolution of mass tort claims against nondebtors.

Ralph Brubaker is the James H.M. Sprayregen Professor of Law at the University of Illinois. *The author is very grateful to Troy McKenzie, Bob Lawless, Josh Silverstein, Douglas Baird, Vince Buccola, Adam Levitin, Charles Tabb, and Rick Marcus for helpful comments and conversations.*

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and that wants a global settlement at all costs, plaintiffs caught up in MDLs have little bargaining leverage."); *cf.* BURCH, *supra* note 105, at 108 ("When [MDL transferee] judges don't engage with the merits through pretrial motions and trials, the relative strength of plaintiffs' cases may matter little in settlement negotiations.").

221. *See* 28 U.S.C. §§ 157(b)(5), 1411(a) (2018).

222. Technically, nonconsenting plaintiffs do not affirmatively "opt out" of a non-class aggregate settlement, such as an MDL settlement or, for example, a settlement in conjunction with a § 157(b)(5) consolidation of victims' claims against *ND*. Rather, they fail to affirmatively "opt in." *See* Erichson, *supra* note 143, at 1812. As discussed *supra* notes 191-196 and accompanying text, the district court in *D*'s home-court district would have substantial venue flexibility for resolution of the tort claims of such residual "opt out" plaintiffs against *ND*. It could (1) retain those cases in the home-court district, (2) transfer them to the districts where each claim arose (e.g., where the plaintiff was injured), or (3) permit them to proceed in the (state or federal) courts in which they were originally filed via abstention and remand.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: PARLEMENT TECHNOLOGIES, INC, (f/k/a Parler LLC, f/k/a Parler, Inc.), Debtor.	Chapter 11 Case No. 24-10755 (CTG) **Related Docket No. 61**

MEMORANDUM OPINION

The Bankruptcy Code's automatic stay halts litigation against the debtor upon the filing of a bankruptcy case, affording the debtor a "breathing spell" during which the debtor can focus on the work of the bankruptcy. The bankruptcy filing typically does not, however, stay lawsuits against non-debtors. But cases have long recognized that bankruptcy courts may enter a preliminary injunction that operates to stay actions against non-debtors. Courts have at times described the authority to enter such a preliminary injunction as the power to "extend the stay."

The debtor here seeks such a preliminary injunction. The debtor and a number of its former officers are defendants in a suit that was filed in state court in Nevada. The claim against the debtor is, of course, stayed by § 362 of the Bankruptcy Code. The debtor seeks a temporary stay of the action against its former officers. The plaintiff in the Nevada lawsuit, John Matze, opposes the motion.

The Supreme Court recently held in *Purdue Pharma* that non-debtors may not receive permanent injunctive relief in the form of a third-party release, under a plan of reorganization, even when a bankruptcy court finds that the release is necessary to facilitate the debtor's reorganization.[1] That holding raises the question whether courts may grant third parties the protection of a preliminary injunction. The Court concludes that *Purdue Pharma* does not preclude the entry of such a preliminary injunction but does affect how courts should consider what is meant by "likelihood of success on the merits" when applying the traditional four-factor test applicable to requests for preliminary injunctions.

Following *Purdue Pharma*, "success on the merits" cannot be based on the likelihood that the non-debtor would be entitled to a non-consensual third-party release through the plan process. But a preliminary injunction may still be granted if the Court concludes that (a) providing the debtor's management a breathing spell from the distraction of other litigation is necessary to permit the debtor to focus on the reorganization of its business *or* (b) because it believes the parties may ultimately be able to negotiate a plan that includes a consensual resolution of the claims against the non-debtors. Both of those outcomes may be viewed as "success on the merits" for this purpose. Granting a preliminary injunction based on a finding that the debtor is likely to succeed in this sense (which is how bankruptcy courts that have entered such preliminary injunctions have typically described the basis for doing so) does not depend at all on the principle rejected by *Purdue Pharma* that a bankruptcy court may grant a non-consensual third-party release.

Nevertheless, the party seeking a preliminary injunction still bears the burden of demonstrating its entitlement to that relief. Based on the record presented at the

[1] *Harrington v. Purdue Pharm L.P.*, 144 S. Ct. 2071 (2024).

hearing on the debtor's motion, the Court concludes that the debtor has not met its burden. The motion will therefore be denied.

Factual and Procedural Background

The debtor in this bankruptcy case once operated a conservative social media site, known as Parler. In March 2021, the company's former executive, John Matze, filed a nine-count complaint in Nevada state court against the debtor and certain of its owners and former executives.[2] The complaint alleges that the Parler app was suspended from Apple's App Store because the company had not taken sufficient steps to prevent the app from being used to incite violence, including the violence that took place on January 6, 2021 in Washington, D.C. The complaint further asserted that there was a scheme among the defendants to oust Matze and deprive him of his stake in the company. That scheme, the complaint alleges, arose out of Matze's "objections to allowing violent extremists to abuse Parler's platform."[3] The complaint asserts claims for breaches of contract, conversion, conspiracy, and tortious discharge, among other counts. Several of the individual defendants have crossclaimed against the debtor, seeking indemnification.[4]

The debtor filed this bankruptcy case in April 2024. The filing of the bankruptcy operated to stay the Nevada Action against the debtor, but not as against

[2] *Matze v. Parler LLC*, *et al.*, No. A-21-831556-B (D. Ct. Clark County, Nev.). This action is referred to as the "Nevada Action." The Complaint, which is attached to Matze's opposition to the motion and docketed at D.I. 70-1, was admitted into evidence during the July 11, 2024 hearing. It is cited as "Nevada Action Complaint."

[3] Nevada Action Complaint ¶ 41.

[4] The crossclaims are also attached to Matze's opposition and were admitted into evidence. They are docketed at D.I. 70-2 and 70-3.

the other defendants. A defendant in the Nevada litigation that also holds an equity interest in the debtor (an entity referred to as "NDMA") is one of two entities that agreed to provide DIP financing to the debtor. The other DIP lender is the debtor's prepetition secured creditor, which is not involved in the Nevada Action.[5]

In May 2024, the debtor removed the Nevada Action from Nevada state court to the U.S. District Court for the District of Nevada on the ground that it was within the federal court's bankruptcy jurisdiction.[6] The debtor then moved to transfer the case to the U.S. District Court for the District of Delaware (where it would be subject to the district court's order of reference, which refers all cases founded on the court's bankruptcy jurisdiction to the bankruptcy court).[7] Matze opposes the motion to transfer and has moved the district court in Nevada to abstain or to remand the case back to the Nevada state court.[8]

On June 14, the debtor filed this motion, which it describes as a motion "to extend the automatic stay" to its co-defendants in the Nevada litigation until August 30, 2024. The debtor asserts that such a preliminary injunction is appropriate primarily because, by virtue of the debtor's asserted obligation to indemnify the other

[5] The DIP loan was approved on an interim basis by order entered on July 3, 2024. D.I. 86. The hearing on final approval of the DIP loan is set for August 12, 2024.

[6] *See Matze v. Parler LLC*, *et al.*, D. Nev. No. 2:24-cv-00826, D.I. 1 (Notice of Removal). At the argument on the motion for a preliminary injunction, counsel for the debtor expressed uncertainty about the jurisdictional basis for removal. The notice itself states that it is based on the district court's bankruptcy jurisdiction set forth in 28 U.S.C. §§ 1334(b) and 1452(a).

[7] *See Matze v. Parler LLC*, *et al.*, D. Nev. No. 2:24-cv-00826, D.I. 11 (Motion to Change Venue or Transfer).

[8] *See id.*, D.I. 19, 20 (opposition to motion to transfer and motion to abstain or remand).

defendants, the action is in substance a claim against the debtor. The debtor further argues that even though the case may not go forward as to it, because the automatic stay does not prevent it from being subject to discovery, having the case go forward against the other parties would impose expense on the bankruptcy estate and prejudice the bankruptcy case.[9] Matze objected to such extension.[10] The Court held a hearing on the motion on July 11, 2024. The parties stipulated to the admission into evidence of various pleadings.[11] Neither party presented other documentary evidence or called any witness to testify.

Jurisdiction

This debtor's motion was brought under §§ 105(a) and 362 of the Bankruptcy Code. As such, it is a matter within the district court's "arising under" jurisdiction set forth in 28 U.S.C. § 1334(b). This case has been referred to the bankruptcy court under 28 U.S.C. § 157(a) and the district court's standing order of reference. As a matter arising under the Bankruptcy Code, this is a core matter within the meaning of § 157(b).

Analysis

I. The authority to "extend the stay" survives *Purdue Pharma* but cannot be premised on a likelihood of obtaining a non-consensual third-party release.

Courts have long recognized the authority of a bankruptcy court to grant a preliminary injunction staying claims against non-debtors. The caselaw is clear that

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[9] D.I. 61.

[10] D.I. 70.

[11] D.I. 91.

such a preliminary injunction, like any other, is governed by the application of the traditional four-factor test.[12]

What is unusual about the kind of preliminary injunction at issue here, however, is the application of the prong that looks at likelihood of success on the merits. In the typical case of a preliminary injunction, that analysis is focused on the likelihood that the party seeking the injunction will ultimately obtain permanent relief against the party against which it seeks the preliminary injunction.

Consider the Third Circuit's decision in *Greater Philadelphia Chamber of Commerce v. City of Philadelphia*.[13] Philadelphia enacted an ordinance that prohibited employers from asking about a prospective employee's wage history. The Chamber of Commerce filed suit, claiming that the ordinance violated its members' rights of free speech. The question of "likelihood of success on the merits," for purposes of the plaintiff's entitlement to a preliminary injunction, was focused on whether the plaintiff would likely obtain a permanent injunction against the enforcement of the ordinance at the conclusion of the lawsuit.[14]

If one were to apply that principle literally in the context of a preliminary injunction in which a debtor seeks to stay a lawsuit against a non-debtor, one might

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[12] *See In re American Film Techs*, 175 B.R. 847, 849 (Bankr. D. Del. 1994) (indicating that courts should consider (1) likelihood that plaintiff will prevail on the merits; (2) irreparable injury to the plaintiff absent an injunction; (3) harm that the defendant will suffer by the injunction; and (4) the public interest.)

[13] 949 F.3d 116 (3d Cir. 2020).

[14] *Id.* at 133. *See also Nken v. Holder*, 556 U.S. 418 (2009) (addressing standards for stay pending appeal and holding that traditional stay factors applied); *SEC v. Chappell,* No. 23-2776 (3d Cir. July 9, 2024) (holding that traditional preliminary injunction factors apply to SEC's request for an asset freeze).

think that, in order to obtain a preliminary injunction, the debtor would need to show that it was likely that it would ultimately obtain a third-party release of that claim. But notwithstanding the apparent logic of that rationale, that is not how courts typically have viewed "likelihood of success on the merits" in the context of motions seeking to preliminarily enjoin suits against non-debtors.

Some of the cases that consider this issue in the bankruptcy context have focused more on avoiding the harm that the litigation against the third parties could cause to the debtor without directly addressing the debtor's right to obtain permanent relief. For example, in *In re American Film*, Judge Walsh noted that the "elements of probable success on the merits and irreparable harm, in the context of this proceeding, are essentially a matter of whether [the debtor] would be seriously adversely affected if the benefit of the automatic stay is not extended to [the litigation against its directors]."[15] The Third Circuit made a similar point in *W.R. Grace*, where it stated that the "standard for the grant of a stay is generally whether the litigation could interfere with the reorganization of the debtor."[16] The implication of these decisions is that "success on the merits" is the debtor's successful confirmation of a plan of reorganization. Perhaps the claims against the third party would be consensually resolved through the plan process. Perhaps the claims against the third party would proceed after the debtor emerged from bankruptcy with a confirmed plan of reorganization. The point, for present purposes, is that unlike the typical

[15] *American Film,* 175 B.R. at 849.

[16] *In re W.R. Grace*, 115 Fed. App'x 565, 570 (3d Cir. 2004) (internal quotation and citation omitted).

circumstance involving a preliminary injunction, these courts did not define success on the merits as the likelihood that the claim against the third party would be, at the end of the case, subject to a permanent injunction.

To be sure, the same concern about interference with the debtor's effort at reorganization that has justified preliminary injunctive relief has also been relied on by those courts that authorized third party releases. For example, the Fourth Circuit held in its 1986 *A.H. Robins* decision that the bankruptcy court has the authority to enter a preliminary injunction against the assertion of claims against third parties. Three years later, in 1989, the Fourth Circuit issued another decision in the *A.H. Robins* bankruptcy case, holding that those claims could be subject to a non-consensual third-party release.

The reasoning of those two opinions is essentially the same. In its 1986 opinion, the court observed that it "seems incontestable that, if the suits are permitted to continue and discovery allowed, any effort at reorganization of the debtor will be frustrated, if not permanently thwarted."[17] While its 1989 holding that Code authorized a third-party release of those claims emphasized "the impact of the proposed suits on the bankruptcy reorganization" and found the release to be appropriate because it was "essential in this case to a workable reorganization."[18]

The Supreme Court's decision in *Purdue Pharma*, of course, rejects the reasoning of the second *A.H. Robins* decision, making clear that bankruptcy courts

[17] *A.H. Robins Co., Inc., v. Piccinin*, 788 F.2d 994, 1008 (4th Cir. 1986).

[18] *In re A.H. Robins Co., Inc.*, 880 F.2d 694, 701-702 (4th Cir. 1989).

lack the authority to grant *permanent* injunctive relief that bars creditors from asserting claims against non-debtor third parties. The "bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants."[19] Accordingly, to the extent a debtor sought to justify a preliminary injunction on the notion that it was likely to succeed on the merits by ultimately obtaining a third-party release, such an argument would now need to fail in light of *Purdue Pharma*.

This Court, however, reads the *Purdue Pharma* decision to do what it said, and to be "confin[ed] … to the question presented."[20] Accordingly, nothing in the decision provides a reason to reconsider the holdings of *American Film*, *W.R. Grace*, or the 1986 decision in *A.H. Robins*. Those cases found preliminary injunctions against third-party claims to be appropriate where the assertion of those claims would interfere with the debtor's reorganization efforts. And while such interference is no longer a lawful basis for *permanently* enjoining the assertion of such a claim, it remains a sufficient basis for the entry of a *preliminary* injunction.

II. The debtor has failed to meet its burden of demonstrating the necessity of the preliminary injunction.

As an initial matter, the debtor seeks the relief in question by way of a motion, while (as Matze points out in his opposition) Bankruptcy Rule 7001(7) states that an action seeking an injunction must be brought by way of adversary proceeding. And

[19] *Purdue Pharma*, 144 S. Ct. at 2088.

[20] *Id.*

it is, to be clear, always the better practice to follow the rules than to violate them. That said, not every technical violation of a rule is a basis to deny relief. To the contrary, Civil Rule 61 (which is made applicable to contested matters like this one by Bankruptcy Rule 9005) explains that the "court must disregard all errors that do not affect any party's substantial rights."[21] And while this Court believes that the formalities associated with an adversary proceeding are more appropriate when the relief sought is an injunction, Matze does not contend that he failed to receive sufficient notice. So while the Court's determination to deny the motion on the merits obviates the need to address this issue, it is certainly not obvious that, in the absence of a claim of inadequate notice, the Court would deny an otherwise meritorious motion for a preliminary injunction on the ground that it was sought by motion rather than by adversary proceeding.

That said, the Court concludes that the debtor has not met its burden of demonstrating an entitlement to preliminary injunctive relief. The law is clear that a party seeking a preliminary injunction has a substantial burden. They are not entered lightly. Rather, "[p]reliminary injunctive relief is an extraordinary remedy, which should be granted only in limited circumstances."[22] The debtor has not established that there is anything extraordinary about the circumstances presented here. Rather, the debtor makes four principal arguments. Based on the record before the Court, none of those four points demonstrates that there is anything sufficiently

[21] Fed. R. Civ. P. 61.

[22] *Ferring Pharms., Inc. v. Watson Pharms., Inc.,* 765 F.3d 205, 210 (3d Cir. 2014) (internal quotation and citation omitted).

exceptional about the circumstances here to warrant the entry of a preliminary injunction.

First, the debtor contends that it is obligated to indemnify its former officers who are defendants in the Nevada Action. The record in this regard includes the debtor's operating agreement, which contains standard language in which the company indemnifies its officers for liabilities they may incur as a result of actions they take on behalf of the company.[23] The record also contains Parler's answers to the claims that seek indemnity, in which it denies that it owes an indemnity obligation.[24]

If a standard corporate obligation to indemnify officers or directors for liability arising out of the performance of their duties were sufficient to warrant a preliminary injunction, there would be nothing at all extraordinary about the relief. It is true, as the debtor points out, that the caselaw talks about, as one basis for granting a preliminary injunction, circumstances in which "there is such an identity between the debtor and the [non-debtor defendants] that the debtor may be said to be the real party defendant and [the effect of a judgment would be to hold the debtor liable]."[25] And there are certainly circumstances in which the allowance or disallowance of a particular claim may have make-or-break significance for the debtor's reorganization efforts. But there is nothing at all in the record before the Court to suggest that is

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[23] D.I. 70-3 at 51 of 64.

[24] D.I. 70-4 ¶¶ 1-18 D.I. 70-5 ¶¶ 29-36.

[25] *McCartney v. Integra Nat'l Bank N.*, 106 F.3d 506, 510 (3d Cir. 1997). *See also American Film*, 175 B.R. at 851.

the case here. Rather, as the Court understands it, the debtor is proposing simply to sell its assets and distribute the proceeds to creditors in accordance with their statutory priority.

While it is true that in such a context, every dollar of indemnity that the debtor may owe to its former officers would operate to dilute the recoveries of other creditors, that is not, without more, a sufficient basis to conclude that minimizing the debtor's indemnity obligation is critical to the success of this bankruptcy case. And the debtor, which bears the burden of proof on this issue, has offered no more. The evidentiary record before the Court is limited to the Nevada Action pleadings and the proof of claim filed by one of the defendants. Indeed, for all one can discern from the record on this motion, it is possible that the estate's assets will turn out to be fully encumbered by the prepetition and post-petition security interests, in which case, the magnitude of the debtor's prepetition indemnity obligations would turn out to be wholly beside the point. For current purposes, it is sufficient to conclude that the debtor has not met its burden of proving that the preliminary injunction, which would operate to limit the debtor's potential indemnity liabilities, is necessary to the success of the bankruptcy case.

Second, the debtor contends that if the Nevada Action goes forward, the debtor will be subject to discovery demands that it cannot afford to meet under the terms of its existing DIP facility. To that end, it bears note that one of the debtor's DIP lenders is itself a defendant in the Nevada Action. To premise the stay on the "necessity" caused by conditions imposed by the very beneficiaries of that stay would be precisely the sort of "bootstrapping" that the Third Circuit expressly rejected in *Combustion Engineering*. There, the debtor argued that an injunction protecting the non-debtor had an affect on the bankruptcy estate and was therefore within the "related to" jurisdiction. The argument was that because the third party's financial contribution to the bankruptcy estate was conditioned on its receipt of the injunction, it fell within the court's subject-matter jurisdiction. The Third Circuit rejected that as circular. If that were a basis for subject-matter jurisdiction, "a debtor could create subject matter jurisdiction over any non-debtor third-party by structuring a plan in such a way that it depended upon third-party contributions."[26]

The same principle applies here. And while the debtor at argument made the fair point that the debtor's secured creditor (another participant in the DIP loan) might not have consented to additional lending coming ahead of its prepetition liens, the absence of any evidence in the record on this issue is fatal to the debtor's position.

In any event, the case law suggests that the cost of participating in discovery will not in the typical case be a basis for granting a third-party injunction.[27] Nothing in the record suggests anything atypical about this case. Accordingly, the costs of discovery do not provide a sufficient basis for the entry of a preliminary injunction.[28]

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[26] *In re Combustion Engineering*, 391 F.3d 190, 228 (3d Cir 2004).

[27] *See Quarrato v. Madison Glob. LLC*, 2023 WL 7212173, at *2 (S.D.N.Y. Nov. 2, 2023) (finding that costs of discovery are an insufficient basis for the imposition of a preliminary injunction); *In re Davis*, 691 F.2d 176, 178 (3d Cir. 1982) (litigation expenses do not justify injunction even when litigation is against a debtor).

[28] The Court understands from the presentation of counsel that the federal district court in Nevada has held discovery in that action in abeyance pending this Court's disposition of this motion. This Court's conclusion is that the pendency of the bankruptcy should not affect the

Third, the debtor contends that the distraction of dealing with the demands of discovery in the Nevada Action may prevent the company's officers from focusing their attentions on the bankruptcy case. There are certainly circumstances in which courts have found that other litigation would distract a debtor's management team from a company's reorganization, and that such distraction could be a basis for a preliminary injunction against the third-party claims. But as Matze's counsel correctly pointed out at argument, in *Uni-Marts*, Judge Walrath rejected that argument in a case in which the debtor's president was a defendant in third-party litigation.[29] Here, the defendants in the Nevada Action are all *former* officers of the debtor. No current officer or director is a party to that lawsuit. Debtor's counsel candidly acknowledged that he was unaware of any case in which a court granted a preliminary injunction based on the risk of distraction to debtor's management in the absence of the members of management being named as parties in the third-party action. Nor has this Court identified such a case. Nothing in the record here provides a reason why this case should be the first.

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conduct of the litigation against non-debtors. That determination is intended to be without prejudice to the rights of the parties to advance whatever arguments they deem appropriate about the efficacy of discovery proceeding in the district court during the pendency of the motions before that court to transfer and/or remand or abstain, which is of course a matter committed to the discretion of the district court.

[29] *In re Uni-Marts, LLC*, 405 B.R. 113, 128 (Bankr. D. Del. 2009) (rejecting the argument of the debtor's president that "that the time demands of the suit will hinder his ability to assist the Debtor in its reorganization efforts" but noting that in different circumstances, courts have found that "diverting critical management resources from the reorganization effort to litigation may constitute 'unusual circumstances' to justify extending the stay") (citing *In re Ionosphere Clubs*, 111 B.R. 423, 435 (Bankr. S.D.N.Y. 1990); *In re Johns–Manville Corp.*, 26 B.R. 420, 426 (Bankr.S.D.N.Y.1983)).

Finally, the debtor contends, in an argument that is a variant on its contention that the third-party suits are in substance claims against the debtor, that it faces the risk of collateral estoppel if the Nevada Action is permitted to proceed to judgment. But the debtor is only seeking a 60-day stay of the Nevada Action. And as described above, that case is now in the district court where the court has before it motions to transfer and to remand or abstain. There is no trial date set in that case and absolutely nothing in the record suggests that there is any risk that it would go to judgment in the 60 days for which the debtor seeks a stay. As such, the record does not support staying the action on account of the risk of the collateral estoppel effect on the bankruptcy estate of any potential judgment in that action.

In sum, application of the four-factor test that governs requests for a preliminary injunction provides no basis to stay the third-party claims. Because the debtor has not demonstrated that staying the Nevada Action is critical to the success of the bankruptcy case, the Court concludes that it has not established either the first or second factors of the test – likelihood of success on the merits or that it will suffer irreparable injury absent the injunction. Because the debtor cannot establish these factors, that is essentially the end of the analysis.[30] Alternatively, however, if the Court were to engage in the full four-factor balance, it would conclude that they do

[30] *See Reilly v. City of Harrisburg*, 858 F.3d 173, 179 (3d Cir. 2017) ("[A] movant for preliminary equitable relief must meet the threshold for the first two most critical factors: it must demonstrate that it can win on the merits (which requires a showing significantly better than negligible but not necessarily more likely than not) and that it is more likely than not to suffer irreparable harm in the absence of preliminary relief. If these gateway factors are met, a court then considers the remaining two factors and determines in its sound discretion if all four factors, taken together, balance in favor of granting the requested preliminary relief.") (citations and internal quotation omitted).

not warrant the entry of a preliminary injunction against the assertion of the third-party claims.

Conclusion

For the foregoing reasons, the motion for a preliminary injunction will be denied. A separate order will issue.

Dated: July 15, 2024

CRAIG T. GOLDBLATT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Chapter 11
	)	
Coast to Coast Leasing, LLC,	)	Bankr. Case No. 24-03056
	)	
Debtor.	)	Judge Jacqueline P. Cox
	)	
	)	
Coast to Coast Leasing, LLC,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adv. Proceeding No. 24-00172
	)	
M&T Equipment Finance Corporation, et al,	)	
	)	
Defendants	)	
	)	

Opinion Granting Motion for Temporary Restraining Order (Adv. Docket No. 3)

I. Jurisdiction

The court has jurisdiction over this matter under 28 U.S.C. § 1334 and Internal Operating Procedure 15(a) of the U.S. District Court for the Northern District of Illinois. This matter is a "core" proceeding under 28 U.S.C. § 157(b)(2)(A), matters concerning the administration of the estate.

II. Background

This matter comes before the court upon the Motion of the Plaintiff-Debtor, Coast to Coast Leasing, LLC, for Temporary Restraining Order (the "Motion") (Adv. Docket No. 3). The matter was heard in court on July 2, 2024 and on July 16, 2024.

The Motion seeks to enjoin four creditors—M&T Equipment Finance Corporation, Siemens

Financial Services, Inc., De Lage Landen Financial Services, Inc., and Crossroads Equipment Lease and Finance, LLC—from continuing any action in any pending or threatened civil litigation against the Debtor's principals—Hristo (Chris) Angelov, Petar (Peter) Trendafilov, Petar (Peter) Panteleymonov—and its two affiliates, Nationwide Cargo Incorporated and Five Star Garage. Motion (Adv. Docket No. 3), p. 1.

The affected creditors filed Notices of Objections to the Motion. *See* Adv. Docket Nos. 7, 8, 13, and 14. In support of the Motion, the Debtor filed Declarations of the Debtor's principals, the guarantors (Adv. Docket Nos. 15, 16, and 17) as well as a Memorandum of Law in Support of Motion for Temporary Restraining Order ("Memorandum of Law" or "Debtor's Mem. of Law") (Adv. Docket No. 19).

At the July 2, 2024 hearing, counsel for the affected creditors sought to be enjoined appeared and informed the court that the creditors do not consent to the relief sought in the Motion.

After the hearing, on July 2, 2024, the court entered an Order taking the matter under advisement and indicating that the Motion (Adv. Docket No. 3) was withdrawn as to creditor De Lage Landen Financial Services, Inc. *See* Order (Adv. Docket No. 22), ¶¶ 1-3. The court set the matter for a continued hearing on July 16, 2024 at 1:30 p.m.

III. Discussion

This court previously ruled on a similar issue in *In re Gander Partners LLC*, where the court considered consolidated corporate Debtors' Motion for a Preliminary Injunction, which sought to enjoin three state court lawsuits seeking to foreclose on mortgages and recover on the nondebtor principals' guarantees securing the debt. *See* Debtor's Mem. of Law (Adv. Docket No. 19), p. 3 (citations omitted); *In re Gander Partners LLC*, 432 B.R. 781, 783-84, 787-89 (Bankr. N.D. Ill.

2010), *aff'd sub nom. Harris N.A. v. Gander Partners LLC*, 442 B.R. 883 (N.D. Ill. 2011), *vacated* (Feb. 9, 2011). There, the court granted the motion, enjoining the lawsuits against the nondebtor guarantors, finding the three requirements for a bankruptcy court to enjoin proceedings in other courts were met. *Id.* at 788 (citations omitted). In that case, this court noted that in *Fisher*, the Seventh Circuit held that "a bankruptcy court may enjoin proceedings in other courts under the following circumstances: (1) when such proceedings defeat or impair its jurisdiction over the case before it; (2) the moving party has established a likelihood of success on the merits; and (3) the court must consider whether the injunction will harm the public interest." *Id.* at 788 (citing *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir. 1998)).

Subsequently, bankruptcy courts in this district have noted that in the context of a debtor seeking a preliminary injunction, "likelihood of success on the merits" means "the likelihood of a successful reorganization." *In re 1600 Hicks Rd. LLC*, 649 B.R. 172, 181-82 (Bankr. N.D. Ill. 2023) (citations omitted).

A. *Purdue Pharma*

In *Harrington v. Purdue Pharma L.P.*, the U.S. Supreme Court held that "[t]he bankruptcy code does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a nondebtor without the consent of affected claimants." *Harrington v. Purdue Pharma L. P.*, No. 23-124, 144 S. Ct. 2071, 2088 (2024) [hereinafter "*Purdue Pharma*].

In *Purdue Pharma*, the Supreme Court rejected the argument that 11 U.S.C. § 1123(b) permits a bankruptcy court to release *and* enjoin claims against a nondebtor without the claimants' consent. *Purdue Pharma*, 144 S. Ct. at 2081-83 (citations omitted). In a footnote, the Court appeared to also reject the argument that § 105(a) permits such relief. Specifically, the Court stated that "[a]s the Second Circuit recognized, however, '§ 105(a) alone cannot justify' the imposition of nonconsensual third-party releases because it serves only to 'carry out' authorities expressly conferred elsewhere in the code." *Id.* at 2082 n.2 (citing *In re Purdue Pharma L.P.*, 69 F.4th 45, 73 (2d Cir. 2023), *cert. granted sub nom. Harrington v. Purdue Pharma L.P.*, 144 S. Ct. 44, 216 L. Ed. 2d 1300 (2023), *and rev'd & remanded sub nom. Harrington v. Purdue Pharma L. P.*, No. 23-124,144 S. Ct. 2071 (2024); 2 R. Levin & H. Sommer, COLLIER ON BANKRUPTCY ¶105.01[1], p. 105–6 (16th ed. 2023)).

Although like the Sacklers, the guarantors (the nondebtor third parties at issue here) have not filed for bankruptcy, the court finds this scenario is distinguishable from the much broader relief sought in *Purdue Pharma*. *Purdue Pharma*, 144 S. Ct. at 2081. In that case, the Sacklers sought to release and enjoin claims against nondebtor third-parties without the claimants' consent outside of the context of 11 U.S.C. §§ 524(g)(4)(A)(ii).[1]

Here, the guarantors are not seeking a release of claims against them, unlike in *Purdue Pharma*. *Id.* at 2079, 2088. The guarantors, nondebtor third parties, are seeking a temporary restraining order to enjoin creditors from bringing claims against them until August 13, 2024. *See* Proposed Order (Adv. Docket No. 3).

B. Cases After *Purdue Pharma*

The court notes that on July 11, 2024, District Judge Laura Taylor Swain of the Southern District of New York in the Financial Oversight and Management Board for Puerto Rico Bankruptcy

[1] For a discussion of nonconsensual injunctions against third-parties in the asbestos-related bankruptcy context, *see Purdue Pharma*, 144 S. Ct. at 2085 (citing 11 U.S.C. §§ 524(g)(4)(A)(ii) and 1123(b)(6); *Bittner v. United States*, 598 U. S. 85, 94 (2023); *AMG Capital Management, LLC v. FTC*, 593 U. S. 67, 77 (2021)).

(as the Representative of Puerto Rico Electric Power Authority), Case No. 17-04780, extended a litigation stay for at least sixty days in that matter while the parties were ordered to meet with a Mediation Team. Order Regarding PREPA Litigation Stay (Docket No. 5286), *In re Puerto Rico Power Authority*, Bankr. No. 17-04780 (D.P.R. July 11, 2024).

Additionally, on July 15, 2024, the Bankruptcy Court for the District of Delware concluded that *Purdue Pharma* does not preclude bankruptcy courts from granting third parties the protection of a preliminary injunction. *In re Parlement Techs., Inc. (f/k/a Parler LLC, f/k/a Parler, Inc.)*, No. 24-10755 (CTG), 2024 WL 3417084, slip op. at *1 (Bankr. D. Del. July 15, 2024) (citations omitted). The Bankruptcy Court for the District of Delware concluded that "[f]ollowing *Purdue Pharma*, 'success on the merits' cannot be based on the likelihood that the non-debtor would be entitled to a non-consensual third-party release through the plan process." *In re Parlement Techs., Inc.*, 2024 WL 3417084, slip op. at at *1.

That court ruled that "[a] preliminary injunction may still be granted if the Court concludes that (a) providing the debtor's management a breathing spell from the distraction of other litigation is necessary to permit the debtor to focus on the reorganization of its business or (b) because it believes the parties may ultimately be able to negotiate a plan that includes a consensual resolution of the claims against the non-debtors," reasoning that both of those outcomes can be viewed as "success on the merits" for this purpose. *Id.* The court reasoned that "[g]ranting a preliminary injunction based on a finding that the debtor is likely to succeed in this sense (which is how bankruptcy courts that have entered such preliminary injunctions have typically described the basis for doing so) does not depend at all on the principle rejected by *Purdue Pharma* that a bankruptcy court may grant a non-consensual third-party release." *Id.* However, the court noted that the burden to show entitlement to a preliminary injunction is still on the party seeking such relief. *Id.*

The court held that a preliminary injunction in that case was not warranted, finding the factors necessary for a preliminary injunction were not met. *Id.* at *7 n.30 (citing *Reilly v. City of Harrisburg*, 858 F.3d 173, 179 (3d Cir. 2017)).

IV. Analysis

In its Memorandum of Law, the Debtor argued there is authority for the relief sought under *In re Gander Partners LLC*. *See* Debtor's Mem. of Law (Adv. Docket No. 19), p. 3 (citing *In re Gander Partners LLC*, 432 B.R. at 787). In *Gander*, the court stated that "[t]he Seventh Circuit held in *Fisher* that a bankruptcy court may enjoin proceedings in other courts under the following circumstances: (1) when such proceedings defeat or impair its jurisdiction over the case before it; (2) the moving party has established a likelihood of success on the merits; and (3) the court must consider whether the injunction will harm the public interest." *Id.* at 788 (citing *Fisher*, 155 F.3d at 882).

In *Gander*, the court found the first requirement, impairment of the court's jurisdiction, was met where the Debtor's principals' assets were a "source of funds for the Debtors' reorganization efforts" and preserving their credit standing would "play a vital role in the Debtors' efforts to refinance" mortgage debt secured by the Debtors' principals' guarantees. 432 B.R. at 783-84, 788. The court reasoned that "[i]f the state court lawsuits [sought to be stayed] lead to judgments against the principals, the principals' credit standings could be adversely affected, endangering the Debtors by decreasing their ability to guarantee the Debtors' efforts to refinance . . . ." the secured debt at issue. *Id.* at 788. Second, the court found that there was a "reasonable likelihood of a successful reorganization" because the Debtors' principals had "contributed their time, energy and money to the Debtors in the past and are capable of continuing to contribute their time, energy and money to the Debtors' future reorganization efforts." *Id*. Lastly, the court found temporarily staying the state court lawsuits served the public interest because "the limited delay" would foster the Debtors' reorganization." *Id.* at 789 ("[P]romoting a successful reorganization is one of the most important public interests.") (quoting *In re Integrated Health Services, Inc.*, 281 B.R. 231, 239 (Bankr. D. Del. 2002)).

Like in *Gander*, here, the Debtor has met its burden to show each requirement is satisfied. *In re Gander Partners LLC*, 432 B.R. at 788. The Debtor argues that its principals at issue are "responsible for all management, accounting and operations" of the Debtor. Motion (Adv. Docket No. 3), ¶ 4, *Coast to Coast Leasing, LLC v. M&T Equip. Fin. Corp.* (*In re Coast to Coast Leasing, LLC*), Ch. 11 Case No. 24-03056, Adv. No. 24-00172. It argues "[i]f they are distracted from these efforts by reason of their having to defend multiple lawsuits, the reorganization . . . would be thwarted and this Court's jurisdiction to oversee the reorganization would be impaired." *Id.* It argues it and/or its affiliate, Nationwide Cargo Incorporated, employs more than 200 drivers who transport food products throughout the country. *Id.*, ¶ 3. It alleges the harm to Debtor far outweighs the harm to the affected creditors, who are "large, often multi-national enterprises, well able to withstand a delay in the pursuit of a lawsuit while a reorganization case proceeds." *Id.*, ¶ 7.

The first requirement is met as the Debtor's principals intend to fund the plan, and their credit will play a vital role in the reorganization efforts. The state court lawsuits could impair this court's jurisdiction to assist the Debtor to reorganize, since the source of funds to assist the reorganization could be jeopardized. *See In re Gander Partners LLC*, 432 B.R. at 788; *see also* Debtor's Mem. of Law (Adv. Docket No. 19), p. 3, *Coast to Coast Leasing, LLC v. M&T Equip. Fin.*

Corp. (*In re Coast to Coast Leasing, LLC*), Ch. 11 Case No. 24-03056, Adv. No. 24-00172 (indicating that the Debtor's principals and entities at issue intend to help fund the plan).

The second requirement, a "reasonable likelihood of a successful reorganization" is met. Similar to *In re Gander Partners LLC*, the Debtors' principals have previously "contributed their time, energy and money to the Debtors" and can continue contributing "their time, energy and money to the Debtors' future reorganization efforts." *In re Gander Partners LLC*, 432 B.R. at 788**.**

Third, temporarily staying the state court lawsuits at issue serves the public interest. The temporary stay may foster the Debtor's reorganization. *Id.* at 789 (quoting *In re Integrated Health Services, Inc.*, 281 B.R. 231, 239 (Bankr. D. Del. 2002)).

IV. Conclusion and Order

For the reasons described above, it is HEREBY ORDERED that:

1. The Motion (Adv. Docket No. 3) is GRANTED.

2. The Defendants, M&T Equipment Finance Corporation, Siemens Financial Services, Inc., and Crossroads Equipment Lease and Finance, LLC are restrained and enjoined, pending a further hearing on Tuesday, July 30, 2024 at 1:30 p.m., from continuing any action against Hristo (Chris) Angelov, Petar (Peter) Trendafilov, Petar (Peter) Panteleymonov, Nationwide Cargo Incorporated, or Five Star Garage in any pending or threatened civil litigation.

3. The court will not require the Movant to give security because adequate protection payments are being made.

4. A separate order consistent with this Opinion will be entered.

5. This Temporary Restraining Order will take effect on July 17, 2024 at 6:00 p.m. It will expire 14 days later, on July 31, 2024 at 6:00 p.m. *See* Fed. R. Bank. P. 7065(b)(2). The court will

consider extending this order at a Status Hearing on July 30, 2024 at 1:30 p.m.

Date: July 17, 2024

ENTER: ______________________________

Chief Judge Jacqueline P. Cox
U.S. Bankruptcy Court
Northern District of Illinois

Bankruptcy Law Letter

FEBRUARY 2022 | VOLUME 42 | ISSUE 2

AN INCIPIENT BACKLASH AGAINST NONDEBTOR RELEASES? (PART I): THE "NECESSARY TO REORGANIZATION" FALLACY

By Ralph Brubaker

The last few months have seen some rather startling developments in the case law regarding so-called nondebtor (or third-party) "releases" and "channeling" injunctions. Such releases have always been controversial,[1] particularly nonconsensual "releases" (a bit of an oxymoron), which permanently extinguish creditors' or shareholders' direct claims of liability against a third-party nondebtor, without the consent (and even over the objection) of those "releasing" creditors and shareholders. Such nonconsensual releases, which typically appear in a Chapter 11 debtor's plan of reorganization, discharge the obligations of a nondebtor in precisely the same manner that confirmation of the plan discharges the debts of the debtor.[2] Indeed, in confirming a plan containing nondebtor release provisions, the court will typically enter a so-called "channeling" injunction permanently barring any assertion of the "released" claims against the "released" nondebtor, in the same manner that the § 524(a) statutory discharge injunction bars asserting discharged claims against the reorganized debtor.

Four recent decisions regarding nondebtor releases could well represent both (1) the high point in judicial permissiveness, followed almost immediately by (2) a stark and severe backlash, which may well portend a growing and more general judicial skepticism (and even open hostility) toward nondebtor releases. The recent high-water marks of judicial permissiveness came from the Eleventh Circuit's decision in *In re Centro Group, LLC*,[3] and the bankruptcy court's confirmation of Purdue Pharma's plan of reorganization,[4] which released the Sackler family from all potential civil liability in conjunction with Purdue's opioid OxyContin.

The potential harbingers of nondebtor releases' decline (or even demise) came with the Southern District of New York

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district court's dramatic reversal of the *Purdue Pharma* confirmation order,[5] holding (inter alia) that the Bankruptcy Code simply does not authorize nonconsensual nondebtor releases. That decision knocked the legs out from under a multi-billion-dollar deal. And then only a few weeks later, the district court for the Eastern District of Virginia vacated confirmation of a plan containing what purported to be *consensual* nondebtor releases, on multiple grounds, including its conclusion that those releases "offended the most fundamental precepts of due process."[6]

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This Part I will analyze the *Centro Group* decision and what it tells us about the supposedly stringent requirement that a nonconsensual nondebtor release purportedly "should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization."[7] In a subsequent issue of *Bankruptcy Law Letter*, I will then look at the sudden, startling, and sensational judicial recoil against releases and analyze what those decisions tell us about the continuing viability of nondebtor releases.

IN RE CENTRO GROUP, LLC

The *Centro Group* case involved a settlement of litigation claims belonging to debtors' Chapter 11 estates and nonconsensual nondebtor releases approved in conjunction therewith.

Centro provided payroll and human resource management services to businesses, including payroll processing. In April of 2018, Centro merged with another payroll and human resource management firm, ProHCM Holdings, Inc., and after the merger Centro became the operating entity for the combined businesses, as a wholly-owned subsidiary of ProHCM.

As part of its payroll processing services, Centro would withdraw money from clients' bank accounts for disbursement to client employees and payroll tax authorities. In conjunction with the merger, Centro represented to ProHCM that it was a profitable company with minimal liability. After the merger, though, ProHCM discovered that Centro evidently had misappropriated money from customer escrow accounts containing funds for payment of customers' payroll taxes. Consequently, Centro had over $1.7 million in liability for the shortfall, an amount in excess of the post-merger companies' capacity to pay, so both companies filed Chapter 11 in October 2018.

"[N]either ProHCM nor Centro sought to reorganize and continue operations" through Chapter 11.[8] Thus, the principal function of the Chapter 11 proceedings was to allocate the assets remaining in the estates as between HCM and Centro and to purse causes of action belonging to the estates against former Centro officers and directors allegedly responsible in various ways for the misappropriation of customers' escrowed payroll tax funds and for misleading ProHCM regarding that misappropriation. Accordingly, Centro filed an adversary proceeding against Centro's former CEO asserting multiple causes of action.

Based upon their investigation, the Debtors and the Creditors' Committee believed that the estates also had viable claims against several other former officers or directors. No lawsuit against these others was ever filed, however, because the parties negotiated a settlement funded by Giraldo Leyva, Jr., one of the potential defendants. Mr. Leyva and his companies (the "Leyva Parties") agreed to pay the debtors' estates $2.6 million, which was an amount sufficient to fully repay the debtors' creditors, including all of the Centro customers whose escrowed payroll tax funds had been misappropriated. In exchange, the debtors' estates would (1) assign to the Leyva Parties their claims against Centro's former CEO and (2) release all potential claims against all of the other potential Centro officer/director defendants, including Mr. Leyva. In addition, the Leyva Parties insisted that the bankruptcy court, in approving the settlement, grant the Leyva parties a nonconsensual release of *all* potential claims against them, *by anyone*, "directly or indirectly relating in any way to . . . any of the claims released by the Debtors" on behalf of their bankruptcy estates.[9]

Initially, it is worth noting that no one doubts the ability of the bankruptcy estate, with court approval under Bankruptcy Rule 9019(a), to settle and release any claim or cause of action belonging to the estate. Indeed, Code § 1123(b)(3)(A) explicitly provides that a Chapter 11 plan of reorganization can "provide for the settlement or adjustment of any claim . . . belonging to . . . the estate."[10]

The only controversial aspect of the settlement in *Centro Group*, therefore, was the nonconsensual nondebtor release whereby the bankruptcy court was asked to extinguish all potential claims that *other* parties (*not* the debtors' bankruptcy estates) might have against the Leyva parties in conjunction with Centro's alleged misappropriation of customer funds and alleged deception of ProHCM. And in that regard, ProHCM's largest preferred shareholder, Joseph Markland, who was the ProHCM CEO before the merger and the CEO of both ProHCM and Centro after the merger, objected to the nonconsensual nondebtor release. Markland claimed "that before the merger, his ProHCM[] shares had a value of $2.8 million, which was 'wiped out' and reduced to 'a few hundred dollars' due to the misappropriation,"[11] yet the proposed release would prevent HCM shareholders from pursing any claims they might have against the Leyva Parties.

The bankruptcy court, though, overruled Markland's objection and approved the proposed settlement, including the nonconsensual nondebtor release provision, finding that the release "was essential to the compromise" in that "Mr. Leyva would not have agreed to the settlement without it."[12] And on appeal, both the district court and the Eleventh Circuit, in an unpublished per curiam opinion, affirmed.

Both the district court and the Eleventh Circuit panel affirmed the nonconsensual nondebtor release at issue in *Centro Group* on the authority of the Eleventh Circuit's 1996 decision of *In re Munford, Inc.*[13] However, *Centro Group* represents a vast and pernicious expansion of the kinds of releases authorized by *Munford*. The *Centro Group* decision also (and likely unwittingly) lays bare the emptiness of the supposedly rigorous and exacting "necessary to reorganization" standard for approval of nonconsensual nondebtor releases.

IN RE MUNFORD, INC.: BARRING CO-DEFENDANT CONTRIBUTION AND INDEMNITY CLAIMS AGAINST A SETTLING DEFENDANT

Munford involved an adversary proceeding against multiple defendants challenging a pre-bankruptcy leveraged buy-out of the debtor corporation, Munford, that allegedly forced it into Chapter 11. The debtor was seeking "money damages in excess of $68 million," and the defendants in that suit included the "debtor's former officers and directors, certain former shareholders and former employees who received monetary benefits from the LBO, and certain financial advisors and consultants who provided services in connection with the LBO."[14] One of the defendants, Valuation Research Corporation ("VRC"), had provided a solvency opinion in connection with the LBO, and the debtor proposed to settle all of the estate's claims against VRC for $350,000.

That proposed settlement with VRC was "conditioned upon the court's entry of an order protecting VRC by permanently barring *joint tortfeasors*," i.e., VRC's *nonsettling co-defendants* in the debtor's lawsuit, "from pursuing *contribution or indemnification claims* against VRC," the settling defendant.[15] The debtor and VRC so requested in seeking the bankruptcy court's approval of the proposed settlement under Bankruptcy Rule 9019(a), and in approving the proposed settlement, the bankruptcy court (over the objection of the nonsettling co-defendants) issued "an order permanently enjoining the *nonsettling defendants* from asserting *contribution and indemnification claims* against VRC."[16] Both the district court and the Eleventh Circuit affirmed that settlement bar order, which was (again) by its terms limited in effect to barring *only* claims of *contribution or indemnity* by nonsettling co-defendants against the settling defendant.[17]

The significance of that limitation, *only* barring contribution or indemnification claims, cannot be overstated. Such a bar is a routine, accepted feature of even nonbankruptcy partial settlements (with less than all defendants). Indeed, the basic nature of common-law contribution and indemnity is such that an order barring contribution or indemnity claims by nonsettling co-defendants against a settling defendant simply gives full effect to the legal consequences of a plaintiff's partial settlement (i.e., with less than all defendants) even in the absence of the bar order.

1. THE NATURE OF CONTRIBUTION AND INDEMNITY LIABILITY

The co-defendants in *Munford* objected to the settlement bar order because it would "eliminate[] any cross claims they ha[d] against VRC for contribution or indemnity under" Georgia state law, "leaving them without recourse."[18] It is generally the case, though, under applicable state law of contribution and indemnity, that a plaintiff's separate settlement with and release of one (but not all) co-defendants immunizes the settling co-defendant from claims of contribution or indemnity by the nonsettling co-defendants. That result follows from the very nature of contribution and indemnity liability.

"An entitlement to indemnity or contribution can potentially arise in any setting in which two parties [A and B] are jointly and severally liable to a third."[19] And the right of contribution or indemnity arises from the benefit conferred by one of those co-liable parties (e.g., A) upon the other (B) by paying more than its relative share of that joint obligation, giving rise to a right of restitution for unjust enrichment.[20]

> The consequence is that A has to that extent performed B's obligation; unless A intended to make a gift to B, such a transaction gives A a prima facie claim in restitution to the extent of B's unjust enrichment. The claim is called indemnity when the liability in question, as between the parties, is altogether the responsibility of B; it is called contribution when A has paid more than A's share of a common liability that is allocated in some proportion between them. The logic and the rationale of the claim in restitution are precisely the same in either case.[21]

The unjust enrichment logic of that restitution claim (for either contribution or indemnification) is as follows: "If [A] renders to a third person a performance for which [A] and [B] are jointly and severally liable," B is unjustly enriched (and thus A is entitled to restitution from B) "to the extent that the effect of [A's performance] is to reduce an enforceable obligation of [B], and as between [A] and [B], the obligation discharged (or the part thereof for which [A] seeks restitution) was primarily the responsibility of [B]."[22]

2. THE COMMON-LAW BAR ON CO-DEFENDANT CONTRIBUTION AND INDEMNITY CLAIMS AGAINST A SETTLING DEFENDANT

No court order or injunction, therefore, is required to bar contribution or indemnity claims by nonsettling co-defendants against a settling defendant. The plaintiff's release of the settling defendant's liability to the plaintiff (in conjunction with the settlement) extinguishes any potential contribution or indemnity claim that nonsettling co-defendants might have had. To understand why, consider the following textbook example:

> In the paradigm case, plaintiff alleges that defendants A and B are jointly liable for damages in the amount of $100,000. Plaintiff eventually reaches a settlement with [B], who pays $25,000 in exchange for an unconditional release of plaintiff's claims against him. [A] refuses to settle and goes to trial. The jury determines that (i) plaintiff's damages are $80,000, and (ii) A and B are jointly responsible on a 50/50 basis.[23]

Question: If A must pay plaintiff more than $40,000 (A's 50% share of plaintiff's damages), will A have a valid contribution claim against B for the amount paid in excess of $40,000?

Answer: No, because the only basis for claiming that A's payment to the plaintiff unjustly enriched B would be that in doing so, A satisfied an obligation of B to the plaintiff. At the time of A's payment, however, B had no more obligation to the plaintiff because the plaintiff had fully released B in conjunction with their settlement agreement; whatever obligation B had to the plaintiff was fully discharged by their settlement. Consequently, "[i]t is the universal rule that a defendant who settles with the plaintiff cannot thereafter be liable in contribution or indemnity to a nonsettling codefendant."[24]

CENTRO GROUP: THE TRANSMOGRIFICATION OF *MUNFORD* SETTLEMENT BAR ORDERS

The order in *Munford* barring the defendants' contribution and indemnity claims against VRC in conjunction with the plaintiff-debtor-estate's release of all claims against VRC was likely nothing more than a declaration and effectuation of the legal effect of approving the release of the estate's claims against VRC, which (as discussed above) the bankruptcy court clearly has the authority to do.[25] Indeed, and as the bankruptcy court in *Munford* pointed out, the *only* contentious issue raised by a separate settlement with some but not all defendants is *not* whether the settling defendants are thereby immunized against subsequent contribution and indemnity claims by nonsettling co-defendants. Rather, "[t]he real issue" is "the judgment reduction method to be used" for nonsettling defendants subsequently adjudicated to be liable to the plaintiff, to take into account the amount the plaintiff already recovered in its prior settlement.[26]

For example, in the hypothetical textbook case posited above, should judgment against A be entered in the amount of $55,000?: plaintiff's total damages of $80,000 minus the $25,000 B paid to the plaintiff in settlement, which is a so-called "pro tanto" (dollar-for-dollar) credit. Or, alternatively, should judgment be entered in the amount of only $40,000?: plaintiff's total damages of $80,000 reduced by B's 50% comparative share, which is a so-called "comparative share" credit.

Choosing the appropriate judgment-credit system for the plaintiff's claims against nonsettling defendants raises a host of difficult policy and administrability issues,[27] and that choice (ultimately, of a pro-tanto credit in *Munford*) was the most consequential aspect of the *Munford* settlement bar order.[28] That is not to say that there are no grounds to object to the legitimacy of the bar on contribution and indemnity claims by nonsettling co-defendants against VRC in *Munford*.[29] But, again, to the extent that the bar order is merely co-extensive with the extinguishment of contribution and indemnity claims that occurs as a matter of law—simply from the estate's release of its claims against a settling defendant and the bankruptcy court's approval thereof—the bar order is relatively benign. Indeed, the proposed Nondebtor Release Prohibition Act, introduced in both the House and Senate in July 2021, which would generally prohibit nonconsensual nondebtor releases, contains an express carveout for such a bar order.[30]

It is widely recognized that the rule barring subsequent contribution and indemnity claims by nonsettling co-defendants against a settling defendant helps facilitate pretrial partial settlements (with less than all of the defendants).[31] Indeed, the Eleventh Circuit emphasized that settlement-facilitation benefit in affirming the *Munford* bar order:

> This is because "[d]efendants buy little peace through settlement unless they are assured that they will be protected against codefendants' efforts to shift their losses through cross-claims for indemnity, contribution, and other causes related to the underlying litigation." But for the bankruptcy court's bar order in this case, for example, VRC would not have entered into the settlement agreement with Munford, Inc. For these reasons, we hold that section 105(a) . . . authorize[s] bankruptcy courts to enter bar orders where such orders are integral to settlement in an adversary proceeding.[32]

That was, however, a rather loose statement of the holding. The strict holding of the court was likely limited to only that which was before the court: "the bankruptcy court ha[d] legal authority to enter the order barring the nonsettling defendants from asserting claims of contribution and indemnity against VRC."[33] This has led to uncertainty over whether a *Munford* settlement bar order can bar *other* claims against a settling defendant—claims other than contribution and indemnity claims *and* claims by parties other than nonsettling co-defendants—as long as barring such claims is "integral to the settlement" (in the sense mentioned by the *Munford* court) in that the defendant will not enter into the settlement agreement without the bar order.

Before the recent *Centro Group* decision, "the Eleventh Circuit ha[d] found only cross-claims for indemnity and contribution among co-defendants or similar claims to be" appropriate for a settlement bar order.[34] Thus, some lower courts have limited *Munford* to its strict holding authorizing bar of "cross-claims for indemnity and contribution among co-defendants."[35] Others, however, have permitted bar of any and *all claims*, *by anyone* against the settling defendant (*or others*), as long as they arose out of the same nucleus of operative fact as the settled claims.[36] That latter approach was followed by both the bankruptcy court and the district court in approving the settlement order barring claims against the Leyva Parties in *Centro Group*.

The Eleventh Circuit affirmed in an unpublished, nonprecedential, per curiam opinion that nicely illustrates why nonconsensual nondebtor releases, more generally, have become such a ubiquitous feature of the bankruptcy landscape.

THE SETTLEMENT-FACILITATION (NON)STANDARD FOR APPROVAL OF SETTLEMENT BAR ORDERS

If settlement bar orders can extinguish *any* claims by *anyone* against a settling defendant (*or others*), as long as they have some factual relationship to the estate's claims against the defendant that are being released, then settlement bar orders are functionally indistinguishable from nonconsensual nondebtor releases approved in Chapter 11 cases.[37] The essential requisite for approval of these broader nondebtor releases, though, is that the release "is necessary for the success of the reorganization"—the standard the Eleventh Circuit adopted in its 2015 *Seaside Engineering* decision.[38] "The more relaxed *Munford* standard,"[39] by contrast, is that the bar order is "essential" or "integral to reaching a settlement agreement between the parties" because "the parties would not have entered into a settlement agreement without it."[40]

The nonconsensual release at issue in *Centro Group* went beyond barring the kind of co-defendant cross-claims for indemnity and contribution at issue in *Munford*. Arguably, then, the broader *Centro Group* release could only be approved under "the more stringent *Seaside* standard"[41] of being necessary to a successful reorganization, by "prevent[ing] claims against nondebtors that would undermine the operations of, and doom the possibility of success for, the reorganized entity."[42] Yet, the Eleventh Circuit acknowledged that the *Centro Group* settlement bar order would *not* and could "*not* . . . ensure success for a reorganized entity," "because neither ProHCM nor Centro sought to reorganize and continue operations."[43]

The Eleventh Circuit reconciled that disconnect by simply expanding the permissible scope of *Munford* settlement bar orders—to go beyond co-defendant cross-claims for settlement and indemnity against a settling defendant—but without explicitly acknowledging (or perhaps even understanding) that it was doing so. Under *Centro Group*, the settlement-facilitation tail of *Munford* wags the bar-order dog, and settlement facilitation justifies barring *any* claim within the court's subject-matter jurisdiction (because it arises from the same core of operative facts as the estate claim being released). Thus, the Eleventh Circuit reasoned as follows:

> Such a bar order is appropriate where the parties would not have entered into a settlement agreement without it, and thus it is "integral" to the settlement. The *Seaside* factors apply to bar orders that are specifically within the reorganization context [in] "unusual cases in which such an order is necessary for the success of the reorganization." . . .
>
> . . . [T]his case is more like *Munford* than *Seaside* because the Bar Order under review was integral to settlement. . . . [T]he purpose of the Bar Order differs from the factual context under *Seaside* because neither ProHCM nor Centro sought to reorganize and continue operations. As such, the purpose of the Bar Order is not to ensure success for a reorganized entity by eliminating liability against third parties but is instead to facilitate a settlement agreement[, so] *Munford* controls . . . .[44]

That reasoning is extremely troubling, on several levels.

Initially, settlement facilitation as a requisite for approval of a settlement bar order provides no limitations whatsoever on approval of nonconsensual release of claims. Nondebtor defendants themselves can manufacture the "evidence" necessary for approving a nonconsensual release/extinguishment of claims against them, because the operative legal rule is simply a self-interested party's negotiation position.

> Therefore, the negotiation position of the nondebtor[-defendant] is preordained by the operative legal rule. The nondebtor[-defendant] will absolutely insist upon receiving a nonconsensual nondebtor release as an inviolable deal-breaker condition of making any . . . settlement . . . , and when the resulting release is presented to the bankruptcy court for approval, will enthusiastically testify accordingly. And truthfully so, since the operative legal rule itself turns on a negotiating position. Even the most obvious bluff, on the stand and under oath, does not risk punishable perjury, because the nondebtor is not so much testifying about objectively verifiable past facts as the nondebtor is testifying about its negotiating position: "I will not . . . settle[] without a nonconsensual nondebtor release."[45]

Moreover, the estate representative/s negotiating the settlement on behalf of the estate will readily compromise the released third-party nondebtor claims against the nondebtor defendant because those claims *do not* belong to the bankruptcy estate. Consequently, the bankruptcy estate and its fiduciary representatives have no authority whatsoever to prosecute those claims,[46] but under *Centro Group* they evidently *do* have the authority to extinguish those claims by agreeing to a settlement that will bring funds into the estate. If the estate can give away someone else's property in order to get a benefit for the estate, obviously the estate will eagerly do so.

Centro Group's authorization of sweeping nonconsensual extinguishment of claims simply because "the parties would not have entered into a settlement agreement without it,"[47] therefore, is a robbing of Peter to pay Paul that obviously "strike[s] at the heart of . . . foundational [due process] rights."[48] What's more, the Eleventh Circuit's posited distinction between "settlements" and "reorganization" is impossible to coherently operationalize, because there is no clean, clear distinction between settlement and reorganization.

THE FALSE DICHOTOMY BETWEEN SETTLEMENTS AND REORGANIZATION

The *Centro Group* decision is predicated on its postulated distinction between (1) nonconsensual nondebtor releases entered "to facilitate a settlement agreement,"[49] which should be governed by "[t]he more relaxed *Munford* [non]standard"[50] just discussed, that "the parties would not have entered into a settlement without it, and thus it is 'integral' to the settlement,"[51] as contrasted with (2) those nonconsensual nondebtor releases approved "within the reorganization context,"[52] which should be governed by "the more stringent *Seaside* standard"[53] that the releases are "necessary for the reorganized entity to succeed."[54]

That, however, is a false dichotomy. Indeed, one of the principle justifications for nonconsensual nondebtor releases in the "reorganization" context, from their very inception, has been the "objective of encouraging negotiated settlement of disputes."[55]

> A confirmed plan of reorganization, to which all of the debtor's creditors and shareholders are parties for purposes of res judicata, is a very powerful means by which to accomplish settlement of the triangular claims implicated by non-debtor actions. In fact, the desire to foster such compromises has been the impetus for consensual nondebtor plan releases. In recognition of the force of the settlement policy in complex reorganizations, courts approving compulsory nondebtor releases clothe their decisions with the rhetoric of compromise and settlement, often emphasizing contributions the non-debtor has agreed to make to the debtor's estate that will enhance the recoveries of all creditors, such as cash payments to or continued services for the debtor.[56]

Particularly in mass tort reorganizations, facilitating settlement is *the* overriding rationale, über alles, for approval of nonconsensual nondebtor releases. Consider, for example, the *Purdue Pharma* case. The bankruptcy court approved nonconsensual nondebtor releases for the Sacklers because the debtor's entire plan of reorganization was predicated on payment by the Sacklers of $4.325 billion (over a period of years) "that settles [1] the estates' claims" against the Sacklers,[57] e.g., for alleged fraudulent transfers and breach of fiduciary duty,[58] as well as [2] "certain third-party claims against the Sacklers related to those claims [by the estate] and the third-party's claims against the Debtors,"[59] and what's more, "the plan contains several other settlements interrelated to those settlements that would not be achievable if either of the settlements with the Sacklers fell away."[60] Thus, the nonconsensual nondebtor release provisions were "necessary" to the "reorganization" because "the plan's third-party release provisions . . . are an essential quid pro quo to the [Sacklers]' settlement,"[61] in that "[u]nderstandably the [Sacklers] are not going to agree to provide the consideration under the settlement without receiving the . . . releases in return."[62]

The nonconsensual nondebtor releases in *Purdue*, therefore, were approved *not* on the basis of a supposedly "more stringent"[63] standard applicable "specifically within the reorganization context."[64] The Sacklers' nonconsensual nondebtor releases were approved under "the more relaxed *Munford* [non]standard"[65] that "the parties would not have entered into a settlement without it, and thus it is 'integral' to the settlement."[66] The *Centro Group* decision, therefore, in its attempt to devise a nonexistent distinction between "settlement" and "reorganization," unwittingly exposes the utter emptiness of the purportedly "stringent" standard[67] that nonconsensual nondebtor releases "should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization."[68]

THE "NECESSARY" TO SUCCESSFUL REORGANIZATION FICTION

The truth about nonconsensual nondebtor releases is that the courts have never required that they be "necessary to successful reorganization" in the sense of saving an operating business from destruction. That is apparent from the many instances, such as *Centro Group*, in which nonconsensual nondebtor releases are approved in "reorganizations" that *liquidate* a defunct business's assets.[69] As applied by the courts, then, necessary to successful reorganization means necessary to do the deal embodied in the plan of reorganization—whether or not those whose third-party claims will be "released" have agreed to the deal—simply because those who negotiated the deal (including the "released" nondebtors) *say* that nonconsensual nondebtor releases are necessary to the deal.

Understandably, then, and despite the admonitions of courts of appeals that nonconsensual nondebtor releases are to be granted cautiously and infrequently, in only rare, unusual, and exceptional circumstances,[70] that has not been the case. As Judge McMahon has insightfully pointed out:

> Anyone can devise a plan that involves contributions from non-debtors who (not surprisingly) would condition their participation on being shielded from *their* creditors. And . . . every . . . corporate bankruptcy [debtor] can come up with some aspect of its situation that seems to it, and to its creditors, to be "unique." So it would be all too easy to . . . make a plan facet that is supposed to be an exception swallow the rule against non-debtor releases.[71]

Thus, there is an inevitable "transformation of relief circuit courts describe as 'extraordinary' into a routine part of nearly every chapter 11 case."[72] Judge Holt has aptly described this as "an example of the Lake Wobegon effect whereby many ordinary and average things are postured as extraordinary, causing the very concept of extraordinariness to lose meaning."[73]

> Permitting the practice of approving nonconsensual nondebtor releases that are "necessary to successful reorganization," while "preach[ing] caution" (as Courts of Appeals have done) is simply extreme naivete—especially if the hope is that this approach will exert any principled restraint on the practice. "Necessary to successful reorganization" is a negotiating position proffered by a nondebtor who will directly benefit from that which it insists is essential to any settlement deal. By positively inviting the nondebtor to manufacture the "evidence" necessary for approval, through its negotiating behavior, this standard virtually guarantees that approval will not and cannot be limited to "rare" and "unusual" cases, which the growing prevalence of the bankruptcy grifter phenomenon vividly illustrates.[74]

Indeed, Jutice Breyer's opinion in *Czyzewski v. Jevic Holding Corp.* made a similar observation in striking down an extra-statutory priority deviation approved using a similar "necessity" fiction. Such a standard "will lead to similar claims being made in many, not just a few, cases," which "threatens to turn a 'rare case' exception into a more general rule."[75] "[O]nce the floodgates are opened, [the negotiating parties] can be expected to make every case that 'rare case.' "[76] And as Judge McMahon put it, in vacating the Sacklers' releases in the *Purdue Pharma* case, "[w]hen every case is unique, none is unique."[77]

ENDNOTES:

[1]See generally Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 U. Ill. L. Rev. 959.

[2]See 11 U.S.C.A. § 1141(d)(1)(A).

[3]In re Centro Group, LLC, 71 Bankr. Ct. Dec. (CRR) 1, 2021 WL 5158001 (11th Cir. 2021), aff'g sub nom. Markland v. Centro Group, LLC, 2021 WL 1705754 (S.D. Fla. 2021).

[4]In re Purdue Pharma L.P., 633 B.R. 53 (Bankr. S.D. N.Y. 2021)

[5]In re Purdue Pharma, L.P., 2021 WL 5979108 (S.D. N.Y. 2021).

[6]Patterson v. Mahwah Bergen Retail Group, Inc., 2022 WL 135398, at *3 (E.D. Va. 2022).

[7]In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070, 1078, 60 Bankr. Ct. Dec. (CRR) 212, 73 Collier Bankr. Cas. 2d (MB) 605, Bankr. L. Rep. (CCH) P 82783 (11th Cir. 2015).

[8]Centro Group, 2021 WL 5158001, at *3.

[9]Markland v. Centro Group, 2021 WL 1705754, at *2.

[10]See Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424-25, 88 S. Ct. 1157, 20 L. Ed. 2d 1 (1968).

[11]Markland v. Centro Group, 2021 WL 1705754, at *2.

[12]Id.

[13]Matter of Munford, Inc., 97 F.3d 449, 29 Bankr. Ct. Dec. (CRR) 1087, 36 Collier Bankr. Cas. 2d (MB) 1604, 35 Fed. R. Serv. 3d 1538 (11th Cir. 1996), aff'g 172 B.R. 404 (Bankr. N.D. Ga. 1993).

[14]Munford, 172 B.R. at 408.

[15]Id. (emphasis added).

[16]Munford, 97 F.3d at 452 (emphasis added).

[17]The bankruptcy court's settlement bar order provided:

> **FURTHER ORDERED** that [each of the defendants in the suit other than VRC, listed individually by name] ("*nonsettling defendants*") are *permanently barred*, restrained, and enjoined *from asserting*, commencing or continuing any and all *claims against Valuation Research Corporation for* partial, comparative equitable or total *indemnity or contribution*, however denominated, *for* or on account of *any claim alleged by debtor* in its complaint, as amended, in said adversary proceeding. As a result of this bar order, any and all such claims by said nonsettling defendants, against Valuation Research Corporation are barred, extinguished, satisfied, discharged, and/or otherwise unenforceable.

Munford, 172 B.R. at 414-15 (emphasis added).

[18]Id. at 409.

[19]Restatement (Third) of Restitution and Unjust Enrichment § 23 cmt. a, at 329 (2011) [hereinafter R3RUE]. "Important examples include claims between surety and principal obligor; between co-sureties; between joint promisors on contracts generally; between joint tortfeasors; between principal and agent; between general contractor and subcontractor; between co-fiduciaries; and between partners." Id.

[20]See 1 Palmer, The Law of Restitution § 1.5(d) (1978); see, e.g., Restatement (Second) of Torts: Apportionment of Liability § 22 reporter's note to cmt. b, at 277 (2000) [hereinafter R2TAL] (noting that the rationale for a noncontractual indemnity obligation is "that the indemnitee provided a benefit to the indemnitor, so the indemnitee [i]s entitled to restitution"); R3RUE § 23 cmt. a, at 331 ("Recurring instances of indemnity and contribution in particular contexts [include] indemnity and contribution between joint tortfeasors.").

[21]R3RUE § 23 cmt. a, at 328.

[22]Id. § 23. A similar restitution claim for equitable subrogation arises when A's performance of B's obligation is motivated by the reasonable possibility (but not certainty) that A may also be liable therefor. See id. § 24 & cmt. d.

[23]Andrew Kull & Ward Farnsworth, Restitution and Unjust Enrichment: Cases and Notes 146 (2018).

[24]Id.; see R3RUE § 23 cmt. e, illus. 13 (contribution) & cmt. f, illus. 15 (indemnity); *id.* reporter's note to cmt. e, at 342 (discussing "the rule that contribution between tortfeasors is unavailable against a settling co-defendant"); R2TAL § 23(a) (providing that "[w]hen two or more persons are or may be liable for the same harm and one of them discharges the liability of another by settlement or discharge of judgment, the person discharging the liability is entitled to recover contribution from the other, *unless the other previously had a valid settlement and release from the plaintiff*" (emphasis added)); *id.* cmt. i, at 288 & reporter's note to cmt. i, at 297. A settling defendant's immunity from subsequent noncontractual *indemnity* claims by nonsettling defendants also flows from the rule, frequently applicable, that a "plaintiff's settlement with either party to a relationship supporting indemnity releases the other party to that relationship from liability to the plaintiff." R2TAL § 22 cmt. c, at 273; *id.* § 16 cmt. d, at 136-37 & reporter's note to cmt. d, at 144-45; cf. Restatement (Third) of Suretyship and Guaranty §§ 39-44 & intro. note, at 167 (1996) (setting forth common-law suretyship rules that discharge a surety's obligations upon release of the primary obligor by the obligee).

[25]See *supra* note 10 and accompanying text.

[26]Munford, 172 B.R. at 410.

[27]See generally 2 Dan B. Dobbs, The Law of Torts § 388, at 1084-85 (2001); Richard A. Espstein, Torts § 9.7, at 232-34 (1999); R2TAL cmts. & reporter's note, at 133-47.

[28]The operative provision of the bankruptcy court's bar order, quoted *supra* note 17, therefore, added:

> Provided, however, that to protect the nonsettling defendants from the consequences of this bar order, the court directs that any judgment recovered by plaintiff debtor in said adversary proceeding against nonsettling defendants shall be reduced by the amount of $350,000 paid by Valuation

Research Corporation in connection with the settlement of claims in this litigation.

Munford, 172 B.R. at 415.

[29]Most significantly, neither the bankruptcy court nor the Eleventh Circuit referenced the applicable Georgia law of indemnity and contribution, in support of the bar order, or the appropriate corresponding judgment-credit for the nonsettling co-defendants. Rather, those courts relied instead upon Code § 105(a). See Munford, 172 B.R. at 414, *aff'd*, 97 F.3d at 454-55. All of the estate's claims at issue, however, apparently were Georgia state-law claims. Thus, those courts' creation of a substantive federal common law of indemnity, contribution, and corresponding judgment credits for nonsettling joint tortfeasors was unconstitutional under Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188, 114 A.L.R. 1487 (1938). See generally Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 Yale L.J.F. 960 (2022), https://ssrn.com/abstract=3960117.

Additionally, the bar order made no distinction between contractual indemnity rights and noncontractual, common-law indemnity rights. A plaintiff's separate settlement with a defendant cannot extinguish any contractual indemnity obligations the settling defendant has to nonsettling co-defendants. See R2TAL § 22 cmt. f, at 275 ("contractual indemnity is determined by the terms of the contract"); R3RUE § 23 cmt. f, illus. 15 (recognizing that even in the absence of a restitutionary indemnity claim, indemnitee may have contractual indemnity claim against indemnitor who previously settled and obtained release of plaintiff's claims against indemnitor). Apparently, none of the co-defendants in *Munford* claimed any contractual indemnity rights against VRC. To the extent that settlement bar orders entered on the authority of *Munford* do extinguish nonsettling co-defendants' otherwise-enforceable contractual indemnity rights against a settling defendant, that is also an unconstitutional creation of substantive federal common law under *Erie*.

[30]Each of those bills, in the proposed addition of § 113 to the Bankruptcy Code, provides in § 113(b)(3) that "[n]othing in subsection (a) of this section [prohibiting nonconsensual nondebtor releases and injunctions] shall affect any power the court might have . . . to bar a claim or cause of action for indemnity, reimbursement, contribution, or subrogation against an entity that the estate has released from a claim or cause of action for which the holder of the barred claim or cause of action also is or may be liable or has or may have secured." S. 2497, 117th Cong. § 2(a) (2021) (proposing 11 U.S.C.A. § 113); H.R. 4777, 117th Cong. § 2(a) (2021) (same).

[31]See, e.g., R2TAL § 16 reporter's note to cmt. c ("In order to effectuate partial settlements, the settling tortfeasor must be assured that the settlement agreement finally determines the settling tortfeasor's liability.").

[32]Munford, 97 F.3d at 455 (quoting In re U.S. Oil and Gas Litigation, 967 F.2d 489, 494, Fed. Sec. L. Rep. (CCH) P 96957 (11th Cir. 1992)).

[33]Munford, 97 F.3d at 454.

[34]Brophy v. Salkin, 550 B.R. 595, 600 (S.D. Fla. 2015).

[35]In re Fontainebleau Las Vegas Holdings, LLC, No. 09-21481-BKC-AJC, 2014 Bankr. LEXIS 3505 (Bankr. S.D. Fla. July 11, 2014).

[36]See, e.g., United States v. Hartog, 597 B.R. 673, 680-81 (S.D. Fla. 2019); Brophy, 550 B.R. at 600; In re Land Resource, LLC, 505 B.R. 571, 584 (M.D. Fla. 2014).

[37]Indeed, as discussed *infra*, that was precisely the context and justification for the bankruptcy court's approval of nonconsensual nondebtor releases for the Sacklers in the *Purdue Pharma* case—without those releases, the Sacklers purportedly would not have settled the estate's claims against them (e.g., for fraudulent conveyances and breach of fiduciary duty). See Purdue Pharma, 633 B.R. at 71, 83-84, 91-93, 107 (stating that "the plan's third-party release provisions . . . are an essential quid pro quo to the shareholder released parties' settlement" because "[u]nderstandably the shareholder released parties are not going to agree to provide the consideration under the settlement without receiving the shareholder releases in return").

[38]In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070, 1078, 60 Bankr. Ct. Dec. (CRR) 212, 73 Collier Bankr. Cas. 2d (MB) 605, Bankr. L. Rep. (CCH) P 82783 (11th Cir. 2015).

[39]Markland v. Centro Group, 2021 WL 1705754, at *9.

[40]Centro Group, 2021 WL 5158001, at *2-*3.

[41]Markland v. Centro Group, 2021 WL 1705754, at *10.

[42]Seaside, 780 F.3d at 1077. That was the reasoning of the court in the *Fontainebleu* decision, 2014 Bankr. LEXIS 3505, at *13-*14 & n.6.

[43]Centro Group, 2021 WL 5158001, at *3 (emphasis added).

[44]Id.

[45]Brubaker, 131 Yale L.J.F. at 988-89. The legal standard for approval of the settlement bar order "is a negotiating position proffered by a

nondebtor[-defendant] who will directly benefit from that which it insists is essential to any settlement deal." Id. at 989.

[46]See Caplin v. Marine Midland Grace Trust Co. of New York, 406 U.S. 416, 92 S. Ct. 1678, 32 L. Ed. 2d 195 (1972); Brubaker, 131 Yale L.J.F. at 984 & n.105.

[47]Centro Group, 2021 WL 5158001, at *3.

[48]Patterson, 2022 WL 135398, at *1.

[49]Centro Group, 2021 WL 5158001, at *3.

[50]Markland v. Centro Group, 2021 WL 1705754, at *9.

[51]Centro Group, 2021 WL 5158001, at *3.

[52]Id.

[53]Markland v. Centro Group, 2021 WL 1705754, at *10.

[54]Centro Group, 2021 WL 5158001, at *3.

[55]Brubaker, 1997 U. Ill. L. Rev. at 973.

[56]Id. at 974 (footnotes omitted).

[57]Purdue Pharma, 633 B.R. at 83.

[58]See id. at 91-93.

[59]Id. at 83.

[60]Id.

[61]Id. at 71.

[62]Id. at 107.

[63]Markland v. Centro Group, 2021 WL 1705754, at *10.

[64]Centro Group, 2021 WL 5158001, at *3.

[65]Markland v. Centro Group, 2021 WL 1705754, at *3.

[66]Centro Group, 2021 WL 5158001, at *3.

[67]Markland v. Centro Group, 2021 WL 1705754, at *10.

[68]Seaside, 780 F.3d at 1078.

[69]See Brubaker, 131 Yale L.J.F. at 988 & n.118.

[70]See Patterson, 2022 WL 135398, at *2 ("The Fourth Circuit has made clear that the use of third-party releases is disfavored, saying that such releases should be 'granted cautiously and infrequently,' " and "[o]ther circuits that permit their use likewise reserve their utilization for the rare or exceptional case." (quoting Behrmann v. National Heritage Foundation, 663 F.3d 704, 712, 55 Bankr. Ct. Dec. (CRR) 221, 66 Collier Bankr. Cas. 2d (MB) 1282, Bankr. L. Rep. (CCH) P 82124 (4th Cir. 2011)).

[71]In re Karta Corp., 342 B.R. 45, 55 (S.D. N.Y. 2006).

[72]In re Astria Health, 623 B.R. 793, 801 n.25, 69 Bankr. Ct. Dec. (CRR) 195 (Bankr. E.D. Wash. 2021); see In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726 (Bankr. S.D. N.Y. 2019) ("Almost every proposed Chapter 11 Plan that I receive includes proposed releases."); Patterson, 2022 WL 135398, at *2 (noting that despite court-of-appeals directives that nonconsensual nondebtor releases are to be granted in only rare and exceptional cases, "the Bankruptcy Court for the Richmond Division of this district regularly approves third-party releases").

[73]Astria Health, 623 B.R. at 801 n.25.

[74]Brubaker, 131 Yale L.J.F. at 989 (footnotes omitted and quoting In re Ingersoll, Inc., 562 F.3d 856, 864, 51 Bankr. Ct. Dec. (CRR) 133, 61 Collier Bankr. Cas. 2d (MB) 1202, Bankr. L. Rep. (CCH) P 81469 (7th Cir. 2009)).

[75]Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 986, 197 L. Ed. 2d 398, 63 Bankr. Ct. Dec. (CRR) 242, 77 Collier Bankr. Cas. 2d (MB) 596, 41 I.E.R. Cas. (BNA) 1613, Bankr. L. Rep. (CCH) P 83082 (2017).

[76]Id. (quoting Frederick F. Rudzik, *A Priority Is a Priority Is a Priority—Except When It Isn't*, 34 Am. Bankr. Inst. J., Sept. 2015, at 16, 79).

[77]Purdue Pharma, 2021 WL 5979108, at *3; see also Patterson, 2022 WL 135398, at *2 (stating that the "ubiquity" and "prevalence" of releases "undermines assertions that they are integral to the success of this particular reorganization").

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