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Third-Party Releases

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Hon. Mindy A. Mora, Moderator
U.S. Bankruptcy Court (S.D. Fla.) | West Palm Beach

Kay S. Kress
Troutman Pepper Hamilton Sanders LLP | Detroit

Robert S. 'Steve' Miller
Purdue Pharma, Inc. | Troy, Mich.

NON-CONSENSUAL THIRD-PARTY RELEASES IN A CHAPTER 11 PLAN

Prepared by:

Kay Standridge Kress, Troutman Pepper Hamilton Sanders LLP

Judge Mindy A. Mora, U.S. Bankruptcy Court for the Southern District of Florida

Nicole McLemore, Law Clerk to the Hon. Mindy A. Mora

In Conjunction with a Discussion with

Steve Miller, Chairman of the Board of Purdue Pharma

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Introduction: The Purdue Pharma Bankruptcy

The law concerning non-consensual third-party releases in a chapter 11 plan has been evolving over the last three decades and has become a recent focus of debate in large part due to the *Purdue Pharma*[1] chapter 11 case. The third-party releases at issue in *Purdue* involved the Sackler family and their related affiliates and entities (the "Sackler Family"). The widespread attention the *Purdue* case garnered also spurred discussion in Congress and on Capitol Hill.[2]

The *Purdue* bankruptcy began in September 2019 when Purdue Pharma L.P., and certain associated companies ("Purdue") filed for chapter 11 protection primarily due to the large number of lawsuits filed against it and certain affiliated non-debtors—principally members of the Sackler Family—which had long owned the privately held company. After years of negotiations with various constituencies, the parties drafted a plan that, if implemented, would afford billions of dollars for the resolution of both private and public claims while providing programs that would benefit the public at large.

That plan included, among other things, a $4.325 billion contribution from the Sackler Family and ownership in the company in exchange for a broad release of both direct and derivative claims, including claims predicated on fraud, misrepresentation, and willful misconduct of the Sackler Family under various state

[1] *In re Purdue Pharma, L.P.*, No. 21 CV 7532 (CM), 2021 WL 5979108, at *1 (S.D.N.Y. Dec. 16, 2021), certificate of appealability granted, No. 21 CV 7532 (CM), 2022 WL 121393 (S.D.N.Y. Jan. 7, 2022).

[2] *See, e.g.,* Nondebtor Release Prohibition Act of 2021, H.R. 4777 (S.2497), 117th Cong. (2021-22) and the SACKLER Act, H.R. 2096 (S.2472), 117th Cong. (2021-22).

consumer protection statutes. The members of the Sackler Family would receive the releases despite not filing for bankruptcy themselves.

The plan was approved by a supermajority of the votes cast by members of each class of creditors entitled to vote. The following entities voted against the plan and filed objections to confirmation: eight states, the District of Columbia, certain Canadian municipalities and Canadian indigenous tribes, the City of Seattle, and 2,683 individual personal injury claimants (the "Objectors"). The Office of the U.S. Trustee and the U.S. Attorney's Office for the Southern District of New York on behalf of the United States joined the Objectors in appealing the Confirmation Order (the "Appellants").

After numerous days of the confirmation hearing and many amendments to the chapter 11 plan narrowing the releases, Judge Drain, on September 17, 2021, confirmed Purdue's plan of reorganization (the "Confirmation Order").[3] In the Confirmation Order, Judge Drain cited to Second Circuit precedent approving nonconsensual third-party releases in unusual circumstances. *See*, *e.g.*, *Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 142 (2d Cir. 2005), which held that non-debtor releases in a plan should not be approved absent findings that there exist truly unusual circumstances to render the releases important to the success of the plan. In *Metromedia*, the Second

[3] The litigation in *Purdue* did not end with entry of the Confirmation Order. Parties pursued an appeal of the Confirmation Order in the District Court and subsequently, the Second Circuit. Meanwhile, the Sackler Family engaged in continued settlement discussions. On March 9, 2022, the bankruptcy court approved a revised settlement agreement over the objection of the Department of Justice and 20 U.S. states, including Florida. The revised settlement agreement includes payments totaling $5.5-6 billion. *In re Purdue Pharma L.P., et al.*, No. 19-23649 (Bankr. S.D.N.Y. filed Sept. 15, 2019) [ECF No. 4503].

Circuit focused on (a) the global settlement of massive liabilities against debtors and co-liable parties, and (b) substantial financial contributions from non-debtor co-liable parties providing compensation to claimants in exchange for the release of their liabilities, which makes the reorganization feasible.[4]

Specifically, the Second Circuit identified the following factors that a court should consider when evaluating such releases in the future:

(1) the release is important to the plan,

(2) the enjoined claims would be channeled to a settlement fund rather than extinguished,

(3) the estate receives substantial consideration in return,

(4) the released claims would otherwise indirectly impact reorganization by way of indemnity or contribution, and

(5) the plan otherwise provided for the full payment of the enjoined claims.

Id. at 141-42.

In so stating, the *Metromedia* court cited to the decisions of the courts of appeals of the Second Circuit, Third Circuit and Sixth Circuit (*SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.),* 960 F. 2d (2d Cir. 1992), *Gillman v. Cont'l Airlines (In re Cont'l Airlines*, 203 F. 3d 203 (3d Cir. 2000), *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp*.), 280 F.3d 648 (6th Cir. 2002)).

[4] In spite of the ruling, the court in *Metromedia,* however, took no action to invalidate the release because it determined that the appeal was equitably moot. *Metromedia*, 416 F.3d at 145.

The Majority Approach

The majority[5] of federal circuit courts have allowed or approved non-consensual third-party releases as part of a chapter 11 plan, although the circuits are splintered on the governing standard.[6] Interestingly, until the December 2021 *Purdue* district court decision, the general consensus was that the Second Circuit followed the majority line of cases allowing third-party releases under certain circumstances.

In addition to the cases cited above from the Second Circuit, the following majority line of cases have addressed the issue:

- *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973 (1st Cir. 1995) – holding that the bankruptcy court made the requisite predicate finding for a broad "incidental" injunction as enumerated in *A.H. Robins*: (i) the injunction was essential to garner the plan contributors' cooperation in the debtor's reorganization, and (ii) the debtor's creditors overwhelmingly approved the injunctive provisions. Interestingly, the issue arose over the post-confirmation violation of a chapter 11 plan injunction when the debtor's affiliate sued former counsel for legal malpractice in the Massachusetts Superior Court. The issue on appeal was not in the context of the appeal of the confirmation order, but rather a collateral estoppel issue of the plan releases.
- *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000) – holding that nonconsensual releases are allowed only with specific findings of fairness if they are necessary to the reorganization. The court declined to decide whether there is a blanket rule against nonconsensual releases but rather assumed the most

[5] The First, Second, Third, Fourth, Sixth, Seventh, Eleventh, and D.C. Circuits are traditionally understood to have adopted the majority approach.

[6] The Eighth Circuit Court of Appeals has not yet ruled on the issue. The bankruptcy court for the Western District of Missouri, in *In re Master Mortgage Investment Fund, Inc.* 168 B.R. 930, 937 (Bankr. W.D. Mo 1994) held that § 524(e) did not prohibit the court from issuing a permanent injunction and under the circumstances of the case, allowed the permanent injunction protecting non-debtor third parties who contributed to the plan.

flexible standard for testing validity and held that the bankruptcy court findings did not support the releases.[7]

- *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019) – holding that the bankruptcy court has constitutional authority under *Stern v. Marshall*,[8] to confirm a chapter 11 plan containing nonconsensual third-party releases and injunctions because the releases and injunctions were "integral to the restructuring of the debtor-creditor relationship." The Third Circuit did not discuss statutory authority in this case.

- *Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.)*, 880 F.2d 694 (4th Cir. 1989) – holding that the release of directors and officers, the debtor, and the insurer's attorneys was essential to the entire reorganization because the plan hinged upon the debtor being free from indirect claims, such as suits against parties who would have indemnity and contribution claims against the debtor. The court considered the following factors:

    - The parties who benefited from the plan injunction contributed funds sufficient to fully satisfy all claims asserted against the debtor;

    - The plan afforded all parties, including late-filed claims, a chance to be paid in full from the trust res;

    - The plan injunction was necessary to prevent suits against parties whose contribution rights against the debtor would defeat the prospects of a successful reorganization, and

    - The affected class voted overwhelmingly in favor of the plan.

- *Behrmann v. Nat'l Heritage Found., Inc.*, 663 F.3d 704 (4th Cir. 2011) – holding that the bankruptcy court's findings that the release provisions of the plan, which exculpated certain third

[7] Bankruptcy courts in the Third Circuit have generally held that consent for releases may be implied in the absence of the execution by a creditor or equity holder of an opt-out form (usually contained as part of the plan ballot). *But see*, *In re Emerge Energy Servs. LP*, No. 19-11563 (KBO), 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019) wherein Judge Owens held that "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."

[8] 564 U.S. 462 (2011).

parties only with respect to claims to be brought by parties-in-interest that had filed a proof of claim or were given notice of debtor's bankruptcy, for acts or omissions arising out of the operations of the debtor's business through the effective date of the plan, did not have the specific factual findings to support such relief.[9] In so holding, the court the found the *Dow Corning* seven-part test and the *Railworks*[10] four part test instructive, stating that nonconsensual third-party releases could only be upheld if:

- They are "essential" to the debtor's reorganization and appropriate due to debtor's unique circumstance;
- An "essential means" of implementing the plan;
- An "integral element" of the transactions contemplated in the plan;
- They present "material benefit" for the debtor, its bankruptcy estate, and its creditors;
- Important to the confirmed plan's overall objectives; and
- Consistent with applicable provisions of the Bankruptcy Code.

The court also held that § 524(e) does not foreclose bankruptcy courts from releasing and enjoining causes of action against non-debtors.

- *In re Dow Corning Corp*., 280 F.3d 648, 658 (6th Cir. 2002) – holding that under certain circumstances, a bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor to facilitate a chapter 11 reorganization plan when the following factors are present:
  - There is an identity of interests between the debtor and the third-party, usually an indemnity relationship, such that a

[9] Upon remand, a different bankruptcy court found the releases unenforceable, the district court affirmed the bankruptcy court, and the Fourth Circuit affirmed, concluding that the debtor "failed to carry its burden of proving that the circumstances of this case justify the Release Provision," relying upon the debtor's failure to meet more than one of the substantive factors enumerated in *In re Dow Corning Corp*., 280 F.3d 648 (6th Cir. 2002) to justify approval of a third party release provision. *Nat'l Heritage Found., Inc. v Highbourne Found.,* 760 F.3d 344, 347 (4th Cir. 2014).

[10] *In re Railworks Corp*., 345 B.R.529, 536 (Bankr. D. Md. 2006) (setting forth factors for a bankruptcy court to analyze when deciding whether to approve non-debtor releases).

suit against the non-debtor is, in essence, a suit against the debtor or will deplete estate assets;

- The non-debtor has contributed substantial assets to the reorganization;
- The injunction is essential to the reorganization, namely the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;
- The impacted class(es) has overwhelmingly voted to accept the plan;
- The plan provides a mechanism to pay all, or substantially all, of the class(es) affected by the injunction;
- The plan provides an opportunity for those claimants who choose not to settle to recover in full; and
- The bankruptcy court made a record of specific factual findings that supports its conclusions.

The court ultimately remanded the case because the decision below did not make sufficiently particularized factual findings of the unusual circumstances allowing the injunction.

- *In re Airadigm Commc'ns, Inc.*, 519 F.3d 640 (7th Cir. 2008) – holding that a bankruptcy court can approve releases of third parties from liability to participating creditors if appropriate under the circumstances and not inconsistent with any provision of the Bankruptcy Code. This "residual authority" is derived from §§ 105(a) and 1123(b)(6), and § 524(e) does not limit the bankruptcy court's powers to release a non-debtor from a creditor's claims. *Id.* at 656-57. The release at issue in *Airadigm* did not include "willful misconduct." *Id.* at 657.[11]

[11] The following year, the Seventh Circuit decided *In re Ingersoll, Inc.*, 562 F.3d 856 (7th Cir. 2009), in which the court held that, in "rare" and "unique" circumstances, bankruptcy courts may approve narrowly tailored releases that are critical to the plan. The court emphasized that releases must still meet the criteria set forth in *Airadigm* and must not provide "blanket immunity". *Id.* at 864-65. Although the release at issue was between non-debtors and non-creditors, the court determined that a party's claim may nonetheless be extinguished if the party received fair notice and an opportunity to object. *Id.* at 865.

- *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1079 (11th Cir. 2015) – agreeing with *Behrmann, Dow Corning,* and *Airadigm* and stating that bankruptcy courts have discretion to consider a non-exclusive list of factors to be applied flexibly and used "infrequently and cautiously" when evaluating the appropriateness of a bar order.[12] The Court also found that § 524(e) does not limit the bankruptcy court's powers to release a non-debtor from a creditor's claims. *Id*. The third-party release at issue was narrowly limited in scope to claims arising out of the chapter 11 case and did not include claims arising out of fraud, gross negligence, or willful misconduct.

Courts that apply the majority view generally rely upon equitable principles found in §§ 105(a) and 1123(b)(6) and reject the idea that § 524(e) prohibits third-party releases. Section 105 provides in pertinent part that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," while § 1123(b)(6) permits a bankruptcy court to "include any other appropriate provision not inconsistent with the applicable provisions of this title." Section 524(e) provides that the "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."

The majority reasons that the language of § 524(e) is consistent with §§ 105(a) and 1123(b)(6), merely explains the effect of a debtor's discharge, and does not prohibit the release of a non-debtor. Under this analysis, the majority reasons that the Bankruptcy Code implicitly allows third-party releases.

[12] The court cited *In re Munford, Inc.*, 97 F.3d 449 (11th Cir. 1996) for the proposition that § 105(a) gives a bankruptcy court authority to approve a release when (i) released parties provided funds to the bankruptcy estate, (ii) the released parties would not have entered into the settlement without the releases, and (iii) the bankruptcy court found that the non-debtor releases are fair and equitable. *Id*. at 1078. In an unpublished decision from November 2021, the court held that *Munford* factors apply to releases in a litigation settlement context and *Seaside* factors apply in a reorganization context. *In re Centro Group, LLC*, 21-11364, 2021 WL 5158001, at *4 (11th Cir. Nov. 5, 2021).

The District of Columbia Circuit, in *In re AOV Indus., Inc.*, 792 F.2d 1140 (D.C. Cir. 1986) implicitly approved non-debtor third party releases under a chapter 11 plan. While the court indicated that it might address whether the third-party release provisions of the debtor's chapter 11 plan violated § 524(e), the court included no direct discussion of § 524(e).[13] Instead, the court determined that the bankruptcy court had jurisdiction to approve the releases but held that the plan violated § 1123(a)(4) because it did not require equal treatment of a member of the unsecured creditor class who failed to settle with the funding non-debtor third parties prior to confirmation of the plan. *Id*. at 1145, 1152. The court was troubled by the requirement that the non-settling creditor had to tender a release of his direct claim to obtain a distribution under the plan and modified the plan provision to exclude from the scope of the release any claims arising from direct guarantees. *Id*. at 1153-54.

The Minority Approach

In contrast, a minority[14] of the courts of appeal have held that nonconsensual third-party releases in a plan are impermissible under the Bankruptcy Code.[15] Those

[13] Other issues on appeal were determined to be equitably moot.

[14] The Fifth, Ninth, and Tenth Circuits have applied the minority approach.

[15] Though the Ninth Circuit has historically taken the minority view, a recent opinion may have cracked the door to approval of exculpation clauses in limited instances. *See Blixseth v. Credit Suisse*, 961 F.3d 1074, 1082 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021). In *Blixseth*, the Ninth Circuit held that § 524(e) does not preclude a bankruptcy court from approving a very narrow exculpation clause if the clause covers actions taken by "participants in plan approval process and relating only to that process." *Id*.

Since the *Blixseth* decision, a small number of Ninth Circuit bankruptcy courts have approved releases in similarly narrow circumstances. *See In re PG&E Corp.*, 617 B.R. 671, 683-84 (Bankr. N.D. Cal. 2020) (concluding that Ninth Circuit law does not preclude voluntary opt-in releases); *In re Astria Health*, 623 B.R. 793 (Bankr. E.D. Wash. 2021).

cases provide that the equitable powers of § 105(a) do not create "residual authority" that is not expressly found in the statutory language of the Bankruptcy Code and may not be exercised in a manner that is inconsistent with other, more specific, provisions of the Code. These courts generally interpret § 524(e) as precluding bankruptcy courts from discharging the liabilities of non-debtors and prohibit nonconsensual third-party releases as a result. *See In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009) (holding that § 524(e) only releases the debtor, not co-liable third parties and determining that only members of the creditors' committee had qualified immunity for actions taken within the scope of their duties pursuant to § 1103(c)); *Ad Hoc Grp. Of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de CV)*, 701 F.3d 1031, 1061 (5th Cir. 2012) (noting that prior 5th Circuit precedent "seem[s] broadly to foreclose non-consensual non-debtor releases and permanent injunctions"); *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995) (determining that § 524(e) displaces a bankruptcy court's equitable power under § 105(a) to order permanent relief against a non-debtor, and precluding a bankruptcy court from discharging the liabilities of non-debtors); *Landsing Diversified Props.-II v. First Natl Bank & Trust Co. (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600-01 (10th Cir. 1990), *modified sub nom. Abel v. West*, 932 F.2d 898 (10th Cir. 1991) (holding that the supplementary equitable powers of § 105(a) may not be exercised in a manner that is inconsistent with § 524 and determining that a temporary stay during the bankruptcy may be permissible to facilitate reorganization, but a permanent injunction in a plan to insulate non-debtors from actions of other non-debtors post-confirmation is not permitted.).

Recent Developments

I. *Purdue Pharma*

On December 16, 2021, Judge McMahon of the District Court in the Southern District of New York issued her 142-page Decision and Order on Appeal vacating the Purdue confirmation order. In reaching that conclusion, the court answered two questions relating to the validity of non-debtor third-party releases under a bankruptcy plan of reorganization:

(1) Did the Bankruptcy Court have subject matter jurisdiction to impose a release of non-debtor claims? The district court determined that the bankruptcy court's "related to" jurisdiction over any civil proceedings that "might have any conceivable effect" on the estate included the civil proceedings asserted against the non-debtor Sackler Family. Therefore, the district court found that the bankruptcy court had subject matter jurisdiction to approve the Section 10.7 Shareholder Release (which consisted of direct claims of third-parties against the non-debtor Sackler Family members, as long as the debtor's conduct or the claims asserted against it are a legal cause or a legally relevant factor).[16]

(2) Did the Bankruptcy Court have statutory authority to approve the non-debtor releases of direct claims against the Sackler Family?[17] Relying on the U.S. Supreme Court's holding in *Stern v. Marshall*, the district court found that

[16] These direct claims arise out of a separate and independent duty that is imposed by statute on individuals who, by virtue of their positions, personally participated in acts of corporate fraud, misrepresentation and/or willful misconduct. *Id*. at 95.

[17] The release of claims against the Sackler Family that are derivative of the estate's claims against them is provided for in Section 10.6(b) of the Purdue plan of reorganization, which was not challenged on appeal as being beyond the power of the bankruptcy court. *Id*. at 94.

neither § 105(a) nor § 1123(a)(5) and (b)(6) provide a bankruptcy court with statutory authority to order the non-consensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan. The district court also determined that bankruptcy courts do not have "equitable authority" or "residual authority," absent a specific, substantive grant of authority in the Bankruptcy Code. Approval of a non-debtor non-consensual third-party release is a non-core proceeding because it relates to a proceeding over which the bankruptcy court merely has "related to" subject matter jurisdiction. In that instance, unless all parties consent to the bankruptcy court's entry of a final judgment disposing of that proceeding, the bankruptcy court is without the constitutional power to enter such a judgment, which the court found included a third-party release. Merely including the non-consensual third-party release in a plan of reorganization does not manufacture the constitutional authority for the bankruptcy court to exercise authority over a proceeding involving solely non-debtor third parties.

Judge McMahon also provided an extensive survey of federal circuit law on the subject of non-consensual release of third-party claims against non-debtors. The district court then analyzed the various sections of the Bankruptcy Code that Judge Drain relied upon to determine that he had authority to approve the non-debtor releases. Ultimately, the district court determined that neither §§ 1123(a)(5), 1123(b)(6), 1129(a)(1), nor the concept of residual authority confers a substantive right allowing a bankruptcy court to approve a release to enforce that right pursuant to § 105(a). Moreover, Judge McMahon was unable to conclude that congressional

silence should be deemed consent to an expansion of the non-debtor releases authorized in asbestos bankruptcy cases under § 524(g).

Judge McMahon was also troubled about the timing of the notice to the releasing parties—many of whom were not named as creditors in the *Purdue* bankruptcy cases. The notice was furnished to those parties months after the claims bar date in *Purdue* had occurred, thereby precluding them from asserting a claim and receiving any consideration for the third-party release that the bankruptcy court sought to impose on them. The district court also focused on the lack of consideration to those releasing parties and the potential legal basis for a bankruptcy court to eradicate a third party claim not asserted against a debtor, especially in light of the district court's interpretation of § 524(e). Judge McMahon interpreted § 524(e) as prohibiting the bankruptcy court from granting a release of claims to a non-debtor under any circumstances, except as expressly contemplated under that subsection.

Based upon this ruling, the district court vacated the bankruptcy court's confirmation order in *Purdue*. Judge McMahon acknowledged that other issues were raised on appeal, which she chose not to address unless her order is reversed on appeal. Given the critical issues at stake in this case, the parties sought, and the district court granted, an interlocutory appeal to the Second Circuit Court of Appeals. On January 27, 2022, the Second Circuit set a briefing schedule and indicated that oral argument will commence on or about the week of April 25, 2022.

II. *Patterson v. Mahwah ("Ascena")*

Just over a month after Judge McMahon issued her ruling in *Purdue*, Judge Novak of the Eastern District of Virginia issued an opinion vacating the confirmation order confirming Mahwah Bergen Retail Group, Inc. f/k/a Ascena Retail Group, Inc.'s plan of reorganization. *Patterson, et al. v. Mahwah Bergen Retail Grp., Inc.*, No. 3:21cv167 (DJN), 2022 WL 135398, at *1 (E.D. Va. Jan. 13, 2022). The district court determined that the bankruptcy court exceeded its constitutional authority by approving a plan which included extremely broad non-consensual third-party releases. As drafted, the third-party releases appeared to "cover any type of claim that existed or could have been brought against anyone associated with Debtors as of the effective date of the plan." *Id*. at *6. As a result, the district court concluded that the claims constituted non-core claims over which the bankruptcy court had "related-to" jurisdiction. Relying upon the Supreme Court's decision in *Stern v. Marshall*, Judge Novak reasoned that the bankruptcy court lacked constitutional authority to approve the releases, which would have constituted a final determination of the third-party claims. At most, the bankruptcy court could have issued a report and recommendation with detailed findings justifying approval of the third-party releases. Any such findings would need to comply with the *Dow Corning* factors, which had been adopted by the Fourth Circuit in *Behrmann*. The district court expressly found that the bankruptcy court failed to undertake that analysis.

The district court was extremely troubled by the adequacy of the notice to the debtors' shareholders. The debtors' noticing agent was unable to confirm how many notices were actually received by shareholders, who had to be served, in many cases,

through a nominee who held the shares. The district court also determined that the opt-out provision included in the notice was deficient because it failed to provide the requisite notice required under the seven-factor test adopted by the Fourth Circuit in *Behrmann*. According to the district court, merely affording a shareholder the right to opt out of the settlement without simultaneously seeking affirmative consent by the shareholder to the exercise of jurisdiction by an Article I judge over a non-core matter also made the shareholder notice inadequate.[18]

Judge Novak then turned to the consideration for the releases. Though the plan provided for the shareholders to exchange a mutual release with the releasing parties as consideration, Judge Novak characterized that consideration as "illusory" because it was unlikely that the officers, directors, employees, and other beneficiaries of the shareholder third party release could ever assert a valid claim against the shareholders that could provide consideration for the release that the shareholders were being asked to make. *Id*. at *30.

Ultimately, the district court concluded that a new confirmation order could be entered approving the plan if the shareholder releases were excised and voided. The court likewise found the exculpation provision in the plan to be overly broad and poorly drafted but determined that there was precedent for approving a properly worded exculpation provision predicated on the *Barton* doctrine (which limits exculpation to estate professionals) and § 1103(c) of the Bankruptcy Code (which

[18] In reaching this conclusion, Judge Novak alluded to the standards for approval of a class action settlement under F.R.C.P. 23, which would have afforded the shareholders the due process to which they were entitled. *Id.* at 29-31.

permits members of an official creditors committee to also receive the benefit of an exculpation provision).

As a final statement regarding what he perceived to be a recurring practice of the bankruptcy judges sitting in the Richmond division of the Eastern District of Virginia approving third-party releases like those in the plan, Judge Novak remanded the bankruptcy case to the chief judge of the bankruptcy court in the Eastern District of Virginia and expressly directed him not to re-assign the case to any bankruptcy judge sitting in the Richmond division. *Id*. at *43. Judge Novak clarified, however, that he held the bankruptcy judge in high regard and directed reassignment to address potential public confidence concerns about the practice of approving third-party releases and forum shopping. *Id*. at *44.

III. *Mallinckrodt*

Judge John Dorsey of the Bankruptcy Court for the District of Delaware recently approved third-party releases in Mallinckrodt PLC and its affiliated debtors' ("Mallinckrodt") Fourth Amended Joint Plan of Reorganization[19] (the "Plan") in February 2022. Mallinckrodt filed for chapter 11 protection in October 2020 in part to address over 3,000 opioid lawsuits filed against it. Its Plan included third-party releases of opioid claims (the "Opioid Releases") and actions arising out of Mallinckrodt's business, restructuring, and the purchase, sale or rescission of any security or indebtedness prior to the Plan's effective date (the "Non-Opioid Releases").

[19] *In re Mallinckrodt PLC, et al.*, No. 20-12522 (Bankr. D. Del. Filed October 12, 2020) [ECF No. 6510].

Judge Dorsey first analyzed whether the settlement, which included the releases, complied with Bankruptcy Rule 9019 and the standards set forth by the Third Circuit in the *Continental* and *Millennium* cases. While Judge Dorsey held that the settlement satisfied the Rule 9019 standard, he did not evaluate the releases contained in the settlement under that standard and instead evaluated the releases under *Continental* and *Millennium*. He found that the releases themselves complied with section 1123(b).

The U.S. Trustee and the state of Rhode Island each objected to approval of the Opioid Releases, arguing that (i) the releases were overbroad, (ii) the releasing parties did not contribute anything of value to the reorganization, and (iii) the bankruptcy court lacked authority to approve the releases. The U.S. Trustee also argued that the court lacked authority to approve the releases and that the releases violated the due process rights of claimants.

Judge Dorsey examined past Third Circuit precedent[20] indicating that a bankruptcy court has core statutory authority to approve a plan but that statutory authority does not necessarily mean that the court has constitutional authority.[21] He observed that bankruptcy courts must evaluate the content of the plan to determine whether the issue is "integral to the debtor-creditor relationship."[22] He also observed that non-consensual third-party releases should be analyzed carefully and approved

[20] *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019).

[21] *In re Mallinckrodt PLC*, No. 20-12522 (JTD), 2022 WL 404323, at *27 (Bankr. D. Del. Feb. 8, 2022).

[22] *Id*.

only if they meet "exacting standards"[23] in "extraordinary cases."[24] The court cited *Continental* for the proposition that the hallmarks of a permissible release are "fairness, necessity to the reorganization, and specific factual findings to support the conclusions."[25]

Taking all of those principles into account, the court found that the releases were necessary to the reorganization and approved them.[26] Judge Dorsey analyzed testimony about the importance of the releases to Mallinckrodt's reorganization, the extensive negotiations that took place, the fairness of the releases to the claimants, and the consideration offered to the claimants. With respect to consideration, the court noted that claimants' potential recovery would likely be greater under the settlement than in other alternative scenarios. In addition, Judge Dorsey concluded that the releases also satisfied the *Master Mortgage* factors.[27]

The court also addressed the U.S. Trustee's argument that the releases violated claimants' due process rights. Specifically, the U.S. Trustee argued that the notice for the releases was unclear about what rights would be extinguished. The court evaluated (i) testimony that 91% of the U.S. adult population and 82% of the

[23] *Id*. at *28 (citing *In re Millennium Lab Holdings II, LLC*, 945 F.3d at 139).

[24] *Id*. at *29.

[25] *Id*.

[26] Interestingly, in a footnote, Judge Dorsey expressed his disagreement with the U.S. Trustee that section 524(e) precludes non-debtor releases. He specifically disagreed that a release is the equivalent of a discharge but recognized that the *Purdue* and *Ascena* district court decisions came to a different conclusion. *Id*. at *30.

[27] *Id*. at *41.

Canadian adult population received notice and (ii) evidence about Mallinckrodt's extensive noticing procedures. In addition, the court acknowledged that while the language about what claims could be extinguished was "dense", there were several factors that mitigated the U.S. Trustee's concerns. Among those factors was the establishment of an opioid trust that would allow claimants a source of recovery. Because there was no claims bar date, both future claimants and claimants who did not receive notice would have the ability to access the funds. Taken together, the court determined that the combination of factors protected the claimants' due process rights.

Faculty

Kay S. Kress is a partner in the Finance & Restructuring Practice Group of Troutman Pepper Hamilton Sanders LLP in Detroit and has experience in restructuring debt and representing secured creditors in federal receivership actions. She also focuses on representing debtors, creditors' committees, secured creditors, trustees, individual creditors and parties in interest — both as lead counsel and co-counsel — in out-of-court workouts and bankruptcy courts in the Eastern District of Michigan, Western District of Michigan, District of Delaware, Southern District of New York and other bankruptcy [districts] nationwide. Ms. Kress co-authored Chapter 83, "Creditors' Committees," for *Colliers Bankruptcy Practice Guide*; co-wrote "Alternatives to Bankruptcy Under Federal and State Law," a chapter in *Navigating in Today's Environment*; and authored the "Federal Receiverships" chapter in *Guide to Receivership and Foreclosure*. She also has written articles for the *Michigan Business Law Journal*; the American Bar Association (ABA) Business Bankruptcy Committee Newsletter, *Business Law Today*; and the *American Bankruptcy Institute Journal*. Ms. Kress has moderated and spoken on a variety of topics, including federal and state receiverships, both locally and nationally. Additionally, she served as ABA Business Law Section advisor to the Uniform Law Drafting Committee for the Uniform Commercial Real Estate Receivership Act. The act was approved by the Uniform Law Commission in July 2015 and has been enacted in seven states. She testified before Michigan House Committee on Judiciary prior to the enactment of the act in Michigan. Ms. Kress is a Fellow of the American College of Bankruptcy and the American College of Finance Lawyers, a council member of the Business Law Section of the ABA, and vice-chair of the Committee on Committees. She received her B.A. *cum laude* from Bowling Green State University in 1978 her J.D. *cum laude* from Wayne State University Law School in 1986, where she was a member of Order of the Coif.

Hon. Mindy A. Mora is U.S. Bankruptcy Judge for the Southern District of Florida in West Palm Beach, appointed on April 6, 2018. She practiced in the areas of bankruptcy, commercial finance, and securitized real estate finance and litigation from 1982-2018 prior to her appointment to the bench by the Eleventh Circuit Court of Appeals. Judge Mora is a Fellow of both the American College of Bankruptcy and the American College of Commercial Finance Attorneys. She previously chaired the Business Law Section of The Florida Bar, which represents the interests of more than 5,000 business lawyers within the State of Florida. Throughout much of her legal practice, she has been active in the development of Florida's commercial laws, most recently as a member of The Florida Bar Business Law Section task force that prepared draft Florida legislation adopting a modified version of the Uniform Commercial Real Estate Receivership Act. Judge Mora is a member of NCBJ (National Conference of Bankruptcy Judges) and has served on its Technology, New Member and Education Committees. She also participates as a member of the Business Law Sections of both the American Bar Association and The Florida Bar, the Association of Commercial Finance Attorneys, the Bankruptcy Bar Association of South Florida, and the International Women's Insolvency & Restructuring Confederation. Judge Mora regularly lectures on commercial law and bankruptcy topics to lawyers and other judges throughout the U.S. From 2018-20, Judge Mora served as the judicial chair of the Local Rules Committee, which promulgated the proposed amendments to the Local Rules for consideration by the bench of the Bankruptcy Court for the Southern District of Florida. She received

her B.B.A. from George Washington University in 1979 and her J.D. from New York University School of Law in 1982.

Robert S. 'Steve' Miller has served as chairman of the board of Purdue Pharma, Inc. since July 1, 2018 in Troy, Mich. Previously, he was president and CEO of International Automotive Components (IAC) from July 2015 until June 2018. Headquartered in Luxembourg, IAC is a tier-one supplier of interior components to the auto industry, with 50 factories and facilities located on all continents and over 20,000 employees. From 2010-15, Mr. Miller served as chairman of the board of American International Group, a global insurance conglomerate, overseeing its recovery from the financial crisis of 2008-09. From 2012-13, he was CEO of Hawker Beechcraft, an airplane manufacturer located in Wichita, Kan., that was restructured in bankruptcy. Prior to that, he served as chairman and CEO of Delphi Corp., a diversified global auto parts supplier, during its restructuring in bankruptcy from 2005-09. Mr. Miller was vice chairman of Chrysler Corp. under Lee Iacocca during 1979-92. He also served as a director of numerous public companies, including Dow Chemical, Symantec, United Airlines, Reynolds Tobacco, Waste Management and US Bank. Mr. Miller received his undergraduate degree in economics in 1963 and his M.B.A. in 1968 from Stanford University, and his J.D. in 1966 from Harvard Law School.