

Southeast Bankruptcy Workshop

Third-Party Releases

Jeffrey R. Waxman, Moderator Morris James LLP | Wilmington, Del.

Jessica C. LauriaWhite & Case LLP | New York

David J. MoltonBrown Rudnick LLP | New York

Andrew R. VaraOffice of the U.S. Trustee | Cleveland

§ 1123. Contents of plan, 11 USCA § 1123

KeyCite Yellow Flag - Negative Treatment Proposed Legislation

United States Code Annotated
Title 11. Bankruptcy (Refs & Annos)
Chapter 11. Reorganization (Refs & Annos)
Subchapter II. The Plan (Refs & Annos)

11 U.S.C.A. § 1123

§ 1123. Contents of plan

Effective: October 17, 2005 Currentness

- (a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall--
 - (1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a) (2), 507(a)(3), or 507(a)(8) of this title, and classes of interests;
 - (2) specify any class of claims or interests that is not impaired under the plan;
 - (3) specify the treatment of any class of claims or interests that is impaired under the plan;
 - (4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;
 - (5) provide adequate means for the plan's implementation, such as--
 - (A) retention by the debtor of all or any part of the property of the estate;
 - **(B)** transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;
 - (C) merger or consolidation of the debtor with one or more persons;
 - **(D)** sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;
 - (E) satisfaction or modification of any lien;

§ 1123. Contents of plan, 11 USCA § 1123

(F) cancellation or modification of any indenture or similar instrument; (G) curing or waiving of any default; (H) extension of a maturity date or a change in an interest rate or other term of outstanding securities; (I) amendment of the debtor's charter; or (J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose; (6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation referred to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting equity securities, and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securities with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; (7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee; and (8) in a case in which the debtor is an individual, provide for the payment to creditors under the plan of all or such portion of earnings from personal services performed by the debtor after the commencement of the case or other future income of the debtor as is necessary for the execution of the plan. (b) Subject to subsection (a) of this section, 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;

§ 1123. Contents of plan, 11 USCA § 1123

- (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.
- (c) In a case concerning an individual, a plan proposed by an entity other than the debtor may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease.
- (d) Notwithstanding subsection (a) of this section and sections 506(b), 1129(a)(7), and 1129(b) of this title, if it is proposed in a plan to cure a default the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

CREDIT(S)

(Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2631; Pub.L. 98-353, Title III, § 507, July 10, 1984, 98 Stat. 385; Pub.L. 103-394, Title II, § 206, Title III, §§ 304(h)(6), 305(a), Title V, § 501(d)(31), Oct. 22, 1994, 108 Stat. 4123, 4134, 4146; Pub.L. 109-8, Title III, § 321(b), Title XV, § 1502(a)(7), Apr. 20, 2005, 119 Stat. 95, 216.)

Notes of Decisions (381)

11 U.S.C.A. § 1123, 11 USCA § 1123

Current through P.L. 117-145. Some statute sections may be more current, see credits for details.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

§ 105. Power of court, 11 USCA § 105

KeyCite Yellow Flag - Negative Treatment Proposed Legislation

United States Code Annotated
Title 11. Bankruptcy (Refs & Annos)
Chapter 1. General Provisions (Refs & Annos)

11 U.S.C.A. § 105

§ 105. Power of court

Effective: December 22, 2010
Currentness

- (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.
- (b) Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.
- (c) The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation.
- (d) The court, on its own motion or on the request of a party in interest-
 - (1) shall hold such status conferences as are necessary to further the expeditious and economical resolution of the case; and
 - (2) unless inconsistent with another provision of this title or with applicable Federal Rules of Bankruptcy Procedure, may issue an order at any such conference prescribing such limitations and conditions as the court deems appropriate to ensure that the case is handled expeditiously and economically, including an order that-
 - (A) sets the date by which the trustee must assume or reject an executory contract or unexpired lease; or
 - (B) in a case under chapter 11 of this title--
 - (i) sets a date by which the debtor, or trustee if one has been appointed, shall file a disclosure statement and plan;
 - (ii) sets a date by which the debtor, or trustee if one has been appointed, shall solicit acceptances of a plan;

§ 105. Power of court, 11 USCA § 105

- (iii) sets the date by which a party in interest other than a debtor may file a plan;
- (iv) sets a date by which a proponent of a plan, other than the debtor, shall solicit acceptances of such plan;
- (v) fixes the scope and format of the notice to be provided regarding the hearing on approval of the disclosure statement; or
- (vi) provides that the hearing on approval of the disclosure statement may be combined with the hearing on confirmation of the plan.

CREDIT(S)

(Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2555; Pub.L. 98-353, Title I, § 118, July 10, 1984, 98 Stat. 344; Pub.L. 99-554, Title II, § 203, Oct. 27, 1986, 100 Stat. 3097; Pub.L. 103-394, Title I, § 104(a), Oct. 22, 1994, 108 Stat. 4108; Pub.L. 109-8, Title IV, § 440, Apr. 20, 2005, 119 Stat. 114; Pub.L. 111-327, § 2(a)(3), Dec. 22, 2010, 124 Stat. 3557.)

Notes of Decisions (1605)

11 U.S.C.A. § 105, 11 USCA § 105

Current through P.L. 117-145. Some statute sections may be more current, see credits for details.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

§ 524. Effect of discharge, 11 USCA § 524

KeyCite Yellow Flag - Negative Treatment Proposed Legislation

United States Code Annotated
Title 11. Bankruptcy (Refs & Annos)
Chapter 5. Creditors, the Debtor, and the Estate (Refs & Annos)
Subchapter II. Debtor's Duties and Benefits

11 U.S.C.A. § 524

§ 524. Effect of discharge

Currentness

- (a) A discharge in a case under this title--
 - (1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, 1192, 1228, or 1328 of this title, whether or not discharge of such debt is waived;
 - (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and
 - (3) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1192, 1228(a)(1), or 1328(a)(1), or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.
- (b) Subsection (a)(3) of this section does not apply if--
 - (1)(A) the debtor's spouse is a debtor in a case under this title, or a bankrupt or a debtor in a case under the Bankruptcy Act, commenced within six years of the date of the filing of the petition in the case concerning the debtor; and
 - (B) the court does not grant the debtor's spouse a discharge in such case concerning the debtor's spouse; or
 - (2)(A) the court would not grant the debtor's spouse a discharge in a case under chapter 7 of this title concerning such spouse commenced on the date of the filing of the petition in the case concerning the debtor; and

- **(B)** a determination that the court would not so grant such discharge is made by the bankruptcy court within the time and in the manner provided for a determination under section 727 of this title of whether a debtor is granted a discharge.
- (c) An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if--
 - (1) such agreement was made before the granting of the discharge under section 727, 1141, 1192, 1228, or 1328 of this title;
 - (2) the debtor received the disclosures described in subsection (k) at or before the time at which the debtor signed the agreement;
 - (3) such agreement has been filed with the court and, if applicable, accompanied by a declaration or an affidavit of the attorney that represented the debtor during the course of negotiating an agreement under this subsection, which states that--
 - (A) such agreement represents a fully informed and voluntary agreement by the debtor;
 - (B) such agreement does not impose an undue hardship on the debtor or a dependent of the debtor; and
 - (C) the attorney fully advised the debtor of the legal effect and consequences of--
 - (i) an agreement of the kind specified in this subsection; and
 - (ii) any default under such an agreement;
 - (4) the debtor has not rescinded such agreement at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim;
 - (5) the provisions of subsection (d) of this section have been complied with; and
 - (6)(A) in a case concerning an individual who was not represented by an attorney during the course of negotiating an agreement under this subsection, the court approves such agreement as-
 - (i) not imposing an undue hardship on the debtor or a dependent of the debtor; and
 - (ii) in the best interest of the debtor.
 - **(B)** Subparagraph (A) shall not apply to the extent that such debt is a consumer debt secured by real property.

- (d) In a case concerning an individual, when the court has determined whether to grant or not to grant a discharge under section 727, 1141, 1192, 1228, or 1328 of this title, the court may hold a hearing at which the debtor shall appear in person. At any such hearing, the court shall inform the debtor that a discharge has been granted or the reason why a discharge has not been granted. If a discharge has been granted and if the debtor desires to make an agreement of the kind specified in subsection (c) of this section and was not represented by an attorney during the course of negotiating such agreement, then the court shall hold a hearing at which the debtor shall appear in person and at such hearing the court shall--
 - (1) inform the debtor--
 - (A) that such an agreement is not required under this title, under nonbankruptcy law, or under any agreement not made in accordance with the provisions of subsection (c) of this section; and
 - (B) of the legal effect and consequences of--
 - (i) an agreement of the kind specified in subsection (c) of this section; and
 - (ii) a default under such an agreement; and
 - (2) determine whether the agreement that the debtor desires to make complies with the requirements of subsection (c)(6) of this section, if the consideration for such agreement is based in whole or in part on a consumer debt that is not secured by real property of the debtor.
- (e) Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.
- (f) Nothing contained in subsection (c) or (d) of this section prevents a debtor from voluntarily repaying any debt.
- (g)(1)(A) After notice and hearing, a court that enters an order confirming a plan of reorganization under chapter 11 may issue, in connection with such order, an injunction in accordance with this subsection to supplement the injunctive effect of a discharge under this section.
- **(B)** An injunction may be issued under subparagraph (A) to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust described in paragraph (2)(B)(i), except such legal actions as are expressly allowed by the injunction, the confirmation order, or the plan of reorganization.
- (2)(A) Subject to subsection (h), if the requirements of subparagraph (B) are met at the time an injunction described in paragraph (1) is entered, then after entry of such injunction, any proceeding that involves the validity, application, construction, or modification of such injunction, or of this subsection with respect to such injunction, may be commenced only in the district

§ 524. Effect of discharge, 11 USCA § 524

court in which such injunction was entered, and such court shall have exclusive jurisdiction over any such proceeding without regard to the amount in controversy.

- (B) The requirements of this subparagraph are that--
 - (i) the injunction is to be implemented in connection with a trust that, pursuant to the plan of reorganization-
 - (I) is to assume the liabilities of a debtor which at the time of entry of the order for relief has been named as a defendant in personal injury, wrongful death, or property-damage actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products;
 - (II) is to be funded in whole or in part by the securities of 1 or more debtors involved in such plan and by the obligation of such debtor or debtors to make future payments, including dividends;
 - (III) is to own, or by the exercise of rights granted under such plan would be entitled to own if specified contingencies occur, a majority of the voting shares of--
 - (aa) each such debtor;
 - (bb) the parent corporation of each such debtor; or
 - (cc) a subsidiary of each such debtor that is also a debtor; and
 - (IV) is to use its assets or income to pay claims and demands; and
 - (ii) subject to subsection (h), the court determines that--
 - (I) the debtor is likely to be subject to substantial future demands for payment arising out of the same or similar conduct or events that gave rise to the claims that are addressed by the injunction;
 - (II) the actual amounts, numbers, and timing of such future demands cannot be determined;
 - (III) pursuit of such demands outside the procedures prescribed by such plan is likely to threaten the plan's purpose to deal equitably with claims and future demands;
 - (IV) as part of the process of seeking confirmation of such plan--

- (aa) the terms of the injunction proposed to be issued under paragraph (1)(A), including any provisions barring actions against third parties pursuant to paragraph (4)(A), are set out in such plan and in any disclosure statement supporting the plan; and
- (bb) a separate class or classes of the claimants whose claims are to be addressed by a trust described in clause (i) is established and votes, by at least 75 percent of those voting, in favor of the plan; and
- (V) subject to subsection (h), pursuant to court orders or otherwise, the trust will operate through mechanisms such as structured, periodic, or supplemental payments, pro rata distributions, matrices, or periodic review of estimates of the numbers and values of present claims and future demands, or other comparable mechanisms, that provide reasonable assurance that the trust will value, and be in a financial position to pay, present claims and future demands that involve similar claims in substantially the same manner.
- (3)(A) If the requirements of paragraph (2)(B) are met and the order confirming the plan of reorganization was issued or affirmed by the district court that has jurisdiction over the reorganization case, then after the time for appeal of the order that issues or affirms the plan--
 - (i) the injunction shall be valid and enforceable and may not be revoked or modified by any court except through appeal in accordance with paragraph (6);
 - (ii) no entity that pursuant to such plan or thereafter becomes a direct or indirect transferee of, or successor to any assets of, a debtor or trust that is the subject of the injunction shall be liable with respect to any claim or demand made against such entity by reason of its becoming such a transferee or successor; and
 - (iii) no entity that pursuant to such plan or thereafter makes a loan to such a debtor or trust or to such a successor or transferee shall, by reason of making the loan, be liable with respect to any claim or demand made against such entity, nor shall any pledge of assets made in connection with such a loan be upset or impaired for that reason;
- (B) Subparagraph (A) shall not be construed to--
 - (i) imply that an entity described in subparagraph (A)(ii) or (iii) would, if this paragraph were not applicable, necessarily be liable to any entity by reason of any of the acts described in subparagraph (A);
 - (ii) relieve any such entity of the duty to comply with, or of liability under, any Federal or State law regarding the making of a fraudulent conveyance in a transaction described in subparagraph (A)(ii) or (iii); or
 - (iii) relieve a debtor of the debtor's obligation to comply with the terms of the plan of reorganization, or affect the power of the court to exercise its authority under sections 1141 and 1142 to compel the debtor to do so.
- (4)(A)(i) Subject to subparagraph (B), an injunction described in paragraph (1) shall be valid and enforceable against all entities that it addresses.

- (ii) Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor to the extent such alleged liability of such third party arises by reason of--
 - (I) the third party's ownership of a financial interest in the debtor, a past or present affiliate of the debtor, or a predecessor in interest of the debtor;
 - (II) the third party's involvement in the management of the debtor or a predecessor in interest of the debtor, or service as an officer, director or employee of the debtor or a related party;
 - (III) the third party's provision of insurance to the debtor or a related party; or
 - (IV) the third party's involvement in a transaction changing the corporate structure, or in a loan or other financial transaction affecting the financial condition, of the debtor or a related party, including but not limited to--
 - (aa) involvement in providing financing (debt or equity), or advice to an entity involved in such a transaction; or
 - (bb) acquiring or selling a financial interest in an entity as part of such a transaction.
- (iii) As used in this subparagraph, the term "related party" means--
 - (I) a past or present affiliate of the debtor;
 - (II) a predecessor in interest of the debtor; or
 - (III) any entity that owned a financial interest in-
 - (aa) the debtor;
 - (bb) a past or present affiliate of the debtor; or
 - (cc) a predecessor in interest of the debtor.
- **(B)** Subject to subsection (h), if, under a plan of reorganization, a kind of demand described in such plan is to be paid in whole or in part by a trust described in paragraph (2)(B)(i) in connection with which an injunction described in paragraph (1) is to be

§ 524. Effect of discharge, 11 USCA § 524

implemented, then such injunction shall be valid and enforceable with respect to a demand of such kind made, after such plan is confirmed, against the debtor or debtors involved, or against a third party described in subparagraph (A)(ii), if-

- (i) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands of such kind, and
- (ii) the court determines, before entering the order confirming such plan, that identifying such debtor or debtors, or such third party (by name or as part of an identifiable group), in such injunction with respect to such demands for purposes of this subparagraph is fair and equitable with respect to the persons that might subsequently assert such demands, in light of the benefits provided, or to be provided, to such trust on behalf of such debtor or debtors or such third party.
- (5) In this subsection, the term "demand" means a demand for payment, present or future, that-
 - (A) was not a claim during the proceedings leading to the confirmation of a plan of reorganization;
 - **(B)** arises out of the same or similar conduct or events that gave rise to the claims addressed by the injunction issued under paragraph (1); and
 - (C) pursuant to the plan, is to be paid by a trust described in paragraph (2)(B)(i).
- (6) Paragraph (3)(A)(i) does not bar an action taken by or at the direction of an appellate court on appeal of an injunction issued under paragraph (1) or of the order of confirmation that relates to the injunction.
- (7) This subsection does not affect the operation of section 1144 or the power of the district court to refer a proceeding under section 157 of title 28 or any reference of a proceeding made prior to the date of the enactment of this subsection.
- (h) Application to existing injunctions.--For purposes of subsection (g)--
 - (1) subject to paragraph (2), if an injunction of the kind described in subsection (g)(1)(B) was issued before the date of the enactment of this Act, as part of a plan of reorganization confirmed by an order entered before such date, then the injunction shall be considered to meet the requirements of subsection (g)(2)(B) for purposes of subsection (g)(2)(A), and to satisfy subsection (g)(4)(A)(ii), if--
 - (A) the court determined at the time the plan was confirmed that the plan was fair and equitable in accordance with the requirements of section 1129(b);
 - (B) as part of the proceedings leading to issuance of such injunction and confirmation of such plan, the court had appointed a legal representative for the purpose of protecting the rights of persons that might subsequently assert demands described in subsection (g)(4)(B) with respect to such plan; and

- (C) such legal representative did not object to confirmation of such plan or issuance of such injunction; and
- (2) for purposes of paragraph (1), if a trust described in subsection (g)(2)(B)(i) is subject to a court order on the date of the enactment of this Act staying such trust from settling or paying further claims--
 - (A) the requirements of subsection (g)(2)(B)(ii)(V) shall not apply with respect to such trust until such stay is lifted or dissolved; and
 - (B) if such trust meets such requirements on the date such stay is lifted or dissolved, such trust shall be considered to have met such requirements continuously from the date of the enactment of this Act.
- (i) The willful failure of a creditor to credit payments received under a plan confirmed under this title, unless the order confirming the plan is revoked, the plan is in default, or the creditor has not received payments required to be made under the plan in the manner required by the plan (including crediting the amounts required under the plan), shall constitute a violation of an injunction under subsection (a)(2) if the act of the creditor to collect and failure to credit payments in the manner required by the plan caused material injury to the debtor.
- (i) Subsection (a)(2) does not operate as an injunction against an act by a creditor that is the holder of a secured claim, if-
 - (1) such creditor retains a security interest in real property that is the principal residence of the debtor;
 - (2) such act is in the ordinary course of business between the creditor and the debtor; and
 - (3) such act is limited to seeking or obtaining periodic payments associated with a valid security interest in lieu of pursuit of in rem relief to enforce the lien.
- (k)(1) The disclosures required under subsection (c)(2) shall consist of the disclosure statement described in paragraph (3), completed as required in that paragraph, together with the agreement specified in subsection (c), statement, declaration, motion and order described, respectively, in paragraphs (4) through (8), and shall be the only disclosures required in connection with entering into such agreement.
- (2) Disclosures made under paragraph (1) shall be made clearly and conspicuously and in writing. The terms "Amount Reaffirmed" and "Annual Percentage Rate" shall be disclosed more conspicuously than other terms, data or information provided in connection with this disclosure, except that the phrases "Before agreeing to reaffirm a debt, review these important disclosures" and "Summary of Reaffirmation Agreement" may be equally conspicuous. Disclosures may be made in a different order and may use terminology different from that set forth in paragraphs (2) through (8), except that the terms "Amount Reaffirmed" and "Annual Percentage Rate" must be used where indicated.
- (3) The disclosure statement required under this paragraph shall consist of the following:

- (A) The statement: "Part A: Before agreeing to reaffirm a debt, review these important disclosures:";
- **(B)** Under the heading "Summary of Reaffirmation Agreement", the statement: "This Summary is made pursuant to the requirements of the Bankruptcy Code";
- (C) The "Amount Reaffirmed", using that term, which shall be--
 - (i) the total amount of debt that the debtor agrees to reaffirm by entering into an agreement of the kind specified in subsection (c), and
 - (ii) the total of any fees and costs accrued as of the date of the disclosure statement, related to such total amount.
- (D) In conjunction with the disclosure of the "Amount Reaffirmed", the statements--
 - (i) "The amount of debt you have agreed to reaffirm"; and
 - (ii) "Your credit agreement may obligate you to pay additional amounts which may come due after the date of this disclosure. Consult your credit agreement.".
- (E) The "Annual Percentage Rate", using that term, which shall be disclosed as-
 - (i) if, at the time the petition is filed, the debt is an extension of credit under an open end credit plan, as the terms "credit" and "open end credit plan" are defined in section 103 of the Truth in Lending Act, then-
 - (I) the annual percentage rate determined under paragraphs (5) and (6) of section 127(b) of the Truth in Lending Act, as applicable, as disclosed to the debtor in the most recent periodic statement prior to entering into an agreement of the kind specified in subsection (c) or, if no such periodic statement has been given to the debtor during the prior 6 months, the annual percentage rate as it would have been so disclosed at the time the disclosure statement is given to the debtor, or to the extent this annual percentage rate is not readily available or not applicable, then
 - (II) the simple interest rate applicable to the amount reaffirmed as of the date the disclosure statement is given to the debtor, or if different simple interest rates apply to different balances, the simple interest rate applicable to each such balance, identifying the amount of each such balance included in the amount reaffirmed, or
 - (III) if the entity making the disclosure elects, to disclose the annual percentage rate under subclause (I) and the simple interest rate under subclause (II); or
 - (ii) if, at the time the petition is filed, the debt is an extension of credit other than under an open end credit plan, as the terms "credit" and "open end credit plan" are defined in section 103 of the Truth in Lending Act, then--

- (I) the annual percentage rate under section 128(a)(4) of the Truth in Lending Act, as disclosed to the debtor in the most recent disclosure statement given to the debtor prior to the entering into an agreement of the kind specified in subsection (c) with respect to the debt, or, if no such disclosure statement was given to the debtor, the annual percentage rate as it would have been so disclosed at the time the disclosure statement is given to the debtor, or to the extent this annual percentage rate is not readily available or not applicable, then
- (II) the simple interest rate applicable to the amount reaffirmed as of the date the disclosure statement is given to the debtor, or if different simple interest rates apply to different balances, the simple interest rate applicable to each such balance, identifying the amount of such balance included in the amount reaffirmed, or
- (III) if the entity making the disclosure elects, to disclose the annual percentage rate under (I) and the simple interest rate under (II).
- (F) If the underlying debt transaction was disclosed as a variable rate transaction on the most recent disclosure given under the Truth in Lending Act, by stating "The interest rate on your loan may be a variable interest rate which changes from time to time, so that the annual percentage rate disclosed here may be higher or lower."
- (G) If the debt is secured by a security interest which has not been waived in whole or in part or determined to be void by a final order of the court at the time of the disclosure, by disclosing that a security interest or lien in goods or property is asserted over some or all of the debts the debtor is reaffirming and listing the items and their original purchase price that are subject to the asserted security interest, or if not a purchase-money security interest then listing by items or types and the original amount of the loan.
- (H) At the election of the creditor, a statement of the repayment schedule using 1 or a combination of the following--
 - (i) by making the statement: "Your first payment in the amount of \$\\$ is due on but the future payment amount may be different. Consult your reaffirmation agreement or credit agreement, as applicable.", and stating the amount of the first payment and the due date of that payment in the places provided;
 - (ii) by making the statement: "Your payment schedule will be:", and describing the repayment schedule with the number, amount, and due dates or period of payments scheduled to repay the debts reaffirmed to the extent then known by the disclosing party; or
 - (iii) by describing the debtor's repayment obligations with reasonable specificity to the extent then known by the disclosing party.
- (I) The following statement: "Note: When this disclosure refers to what a creditor 'may' do, it does not use the word 'may' to give the creditor specific permission. The word 'may' is used to tell you what might occur if the law permits the creditor to take the action. If you have questions about your reaffirming a debt or what the law requires, consult with the attorney who helped you negotiate this agreement reaffirming a debt. If you don't have an attorney helping you, the judge will explain the effect of your reaffirming a debt when the hearing on the reaffirmation agreement is held.".

§ 524. Effect of discharge, 11 USCA § 524

(J)(i) The following additional statements:

"Reaffirming a debt is a serious financial decision. The law requires you to take certain steps to make sure the decision is in your best interest. If these steps are not completed, the reaffirmation agreement is not effective, even though you have signed it.

- "1. Read the disclosures in this Part A carefully. Consider the decision to reaffirm carefully. Then, if you want to reaffirm, sign the reaffirmation agreement in Part B (or you may use a separate agreement you and your creditor agree on).
- "2. Complete and sign Part D and be sure you can afford to make the payments you are agreeing to make and have received a copy of the disclosure statement and a completed and signed reaffirmation agreement.
- "3. If you were represented by an attorney during the negotiation of your reaffirmation agreement, the attorney must have signed the certification in Part C.
- "4. If you were not represented by an attorney during the negotiation of your reaffirmation agreement, you must have completed and signed Part E.
- "5. The original of this disclosure must be filed with the court by you or your creditor. If a separate reaffirmation agreement (other than the one in Part B) has been signed, it must be attached.
- "6. If you were represented by an attorney during the negotiation of your reaffirmation agreement, your reaffirmation agreement becomes effective upon filing with the court unless the reaffirmation is presumed to be an undue hardship as explained in Part D.
- "7. If you were not represented by an attorney during the negotiation of your reaffirmation agreement, it will not be effective unless the court approves it. The court will notify you of the hearing on your reaffirmation agreement. You must attend this hearing in bankruptcy court where the judge will review your reaffirmation agreement. The bankruptcy court must approve your reaffirmation agreement as consistent with your best interests, except that no court approval is required if your reaffirmation agreement is for a consumer debt secured by a mortgage, deed of trust, security deed, or other lien on your real property, like your home.
- "Your right to rescind (cancel) your reaffirmation agreement. You may rescind (cancel) your reaffirmation agreement at any time before the bankruptcy court enters a discharge order, or before the expiration of the 60-day period that begins on the date your reaffirmation agreement is filed with the court, whichever occurs later. To rescind (cancel) your reaffirmation agreement, you must notify the creditor that your reaffirmation agreement is rescinded (or canceled).
- "What are your obligations if you reaffirm the debt? A reaffirmed debt remains your personal legal obligation. It is not discharged in your bankruptcy case. That means that if you default on your reaffirmed debt after your bankruptcy case is over, your creditor may be able to take your property or your wages. Otherwise, your obligations will be determined by the reaffirmation agreement which may have changed the terms of the original agreement. For example, if you are reaffirming an open end credit agreement, the creditor may be permitted by that agreement or applicable law to change the terms of that agreement in the future under certain conditions.
- "Are you required to enter into a reaffirmation agreement by any law? No, you are not required to reaffirm a debt by any law. Only agree to reaffirm a debt if it is in your best interest. Be sure you can afford the payments you agree to make.
- "What if your creditor has a security interest or lien? Your bankruptcy discharge does not eliminate any lien on your property. A 'lien' is often referred to as a security interest, deed of trust, mortgage or security deed. Even if you do not reaffirm and

§ 524. Effect of discharge, 11 USCA § 524

your personal liability on the debt is discharged, because of the lien your creditor may still have the right to take the property securing the lien if you do not pay the debt or default on it. If the lien is on an item of personal property that is exempt under your State's law or that the trustee has abandoned, you may be able to redeem the item rather than reaffirm the debt. To redeem, you must make a single payment to the creditor equal to the amount of the allowed secured claim, as agreed by the parties or determined by the court.".

- (ii) In the case of a reaffirmation under subsection (m)(2), numbered paragraph 6 in the disclosures required by clause (i) of this subparagraph shall read as follows:
- "6. If you were represented by an attorney during the negotiation of your reaffirmation agreement, your reaffirmation agreement becomes effective upon filing with the court.".
- (4) The form of such agreement required under this paragraph shall consist of the following:
- "Part B: Reaffirmation Agreement. I (we) agree to reaffirm the debts arising under the credit agreement described below.
- "Brief description of credit agreement:
- "Description of any changes to the credit agreement made as part of this reaffirmation agreement:
- "Signature: Date:
- "Borrower:
- "Co-borrower, if also reaffirming these debts:
- "Accepted by creditor:
- "Date of creditor acceptance:".
- (5) The declaration shall consist of the following:
 - **(A)** The following certification:
- "Part C: Certification by Debtor's Attorney (If Any).
- "I hereby certify that (1) this agreement represents a fully informed and voluntary agreement by the debtor; (2) this agreement does not impose an undue hardship on the debtor or any dependent of the debtor; and (3) I have fully advised the debtor of the legal effect and consequences of this agreement and any default under this agreement.
- "Signature of Debtor's Attorney: Date:".
 - (B) If a presumption of undue hardship has been established with respect to such agreement, such certification shall state that, in the opinion of the attorney, the debtor is able to make the payment.

§ 524. Effect of discharge, 11 USCA § 524

(C) In the case of a reaffirmation agreement under subsection (m)(2), subparagraph (B) is not applicable.

(6)(A) The statement in support of such agreement, which the debtor shall sign and date prior to filing with the court, shall consist of the following:

"Part D: Debtor's Statement in Support of Reaffirmation Agreement.

"1. I believe this reaffirmation agreement will not impose an undue hardship on my dependents or me. I can afford to make the payments on the reaffirmed debt because my monthly income (take home pay plus any other income received) is \$, and my actual current monthly expenses including monthly payments on post-bankruptcy debt and other reaffirmation agreements total \$, leaving \$ to make the required payments on this reaffirmed debt. I understand that if my income less my monthly expenses does not leave enough to make the payments, this reaffirmation agreement is presumed to be an undue hardship on me and must be reviewed by the court. However, this presumption may be overcome if I explain to the satisfaction of the court how I can afford to make the payments here: . .

"2. I received a copy of the Reaffirmation Disclosure Statement in Part A and a completed and signed reaffirmation agreement."

(B) Where the debtor is represented by an attorney and is reaffirming a debt owed to a creditor defined in section 19(b)(1)(A) (iv) of the Federal Reserve Act, the statement of support of the reaffirmation agreement, which the debtor shall sign and date prior to filing with the court, shall consist of the following:

"I believe this reaffirmation agreement is in my financial interest. I can afford to make the payments on the reaffirmed debt. I received a copy of the Reaffirmation Disclosure Statement in Part A and a completed and signed reaffirmation agreement.".

(7) The motion that may be used if approval of such agreement by the court is required in order for it to be effective, shall be signed and dated by the movant and shall consist of the following:

"Part E: Motion for Court Approval (To be completed only if the debtor is not represented by an attorney.). I (we), the debtor(s), affirm the following to be true and correct:

"I am not represented by an attorney in connection with this reaffirmation agreement.

"I believe this reaffirmation agreement is in my best interest based on the income and expenses I have disclosed in my Statement in Support of this reaffirmation agreement, and because (provide any additional relevant reasons the court should consider):

"Therefore, I ask the court for an order approving this reaffirmation agreement.".

(8) The court order, which may be used to approve such agreement, shall consist of the following:

"Court Order: The court grants the debtor's motion and approves the reaffirmation agreement described above."

(I) Notwithstanding any other provision of this title the following shall apply:

§ 524. Effect of discharge, 11 USCA § 524

- (1) A creditor may accept payments from a debtor before and after the filing of an agreement of the kind specified in subsection (c) with the court.
- (2) A creditor may accept payments from a debtor under such agreement that the creditor believes in good faith to be effective.
- (3) The requirements of subsections (c)(2) and (k) shall be satisfied if disclosures required under those subsections are given in good faith.
- (m)(1) Until 60 days after an agreement of the kind specified in subsection (c) is filed with the court (or such additional period as the court, after notice and a hearing and for cause, orders before the expiration of such period), it shall be presumed that such agreement is an undue hardship on the debtor if the debtor's monthly income less the debtor's monthly expenses as shown on the debtor's completed and signed statement in support of such agreement required under subsection (k)(6)(A) is less than the scheduled payments on the reaffirmed debt. This presumption shall be reviewed by the court. The presumption may be rebutted in writing by the debtor if the statement includes an explanation that identifies additional sources of funds to make the payments as agreed upon under the terms of such agreement. If the presumption is not rebutted to the satisfaction of the court, the court may disapprove such agreement. No agreement shall be disapproved without notice and a hearing to the debtor and creditor, and such hearing shall be concluded before the entry of the debtor's discharge.
- (2) This subsection does not apply to reaffirmation agreements where the creditor is a credit union, as defined in section 19(b) (1)(A)(iv) of the Federal Reserve Act.

CREDIT(S)

(Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2592; Pub.L. 98-353, Title III, §§ 308, 455, July 10, 1984, 98 Stat. 354, 376; Pub.L. 99-554, Title II, §§ 257(o), 282, 283(k), Oct. 27, 1986, 100 Stat. 3115-3117; Pub.L. 103-394, Title I, §§ 103, 111(a), Title V, § 501(d)(14), Oct. 22, 1994, 108 Stat. 4108, 4113, 4145; Pub.L. 109-8, Title II, §§ 202, 203(a), Title XII, § 1210, Apr. 20, 2005, 119 Stat. 43, 194; Pub.L. 111-327, § 2(a)(19), Dec. 22, 2010, 124 Stat. 3559; Pub.L. 116-54, § 4(a)(9), Aug. 23, 2019, 133 Stat. 1086.)

Notes of Decisions (1316)

11 U.S.C.A. § 524, 11 USCA § 524

Current through P.L. 117-145. Some statute sections may be more current, see credits for details.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

§ 1129. Confirmation of plan, 11 USCA § 1129

KeyCite Yellow Flag - Negative Treatment Proposed Legislation

United States Code Annotated
Title 11. Bankruptcy (Refs & Annos)
Chapter 11. Reorganization (Refs & Annos)
Subchapter II. The Plan (Refs & Annos)

11 U.S.C.A. § 1129

§ 1129. Confirmation of plan

Effective: December 22, 2010
Currentness

- (a) The court shall confirm a plan only if all of the following requirements are met:
 - (1) The plan complies with the applicable provisions of this title.
 - (2) The proponent of the plan complies with the applicable provisions of this title.
 - (3) The plan has been proposed in good faith and not by any means forbidden by law.
 - (4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.
 - (5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and
 - (ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and
 - **(B)** the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.
 - **(6)** Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.
 - (7) With respect to each impaired class of claims or interests--

§ 1129. Confirmation of plan, 11 USCA § 1129

(A) each holder of a claim or interest of such class--(i) has accepted the plan; or (ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or (B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims. (8) With respect to each class of claims or interests--(A) such class has accepted the plan; or **(B)** such class is not impaired under the plan. (9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that--(A) with respect to a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim; (B) with respect to a class of claims of a kind specified in section 507(a)(1), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive--(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or (ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; (C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim regular installment payments in cash--(i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;

§ 1129. Confirmation of plan, 11 USCA § 1129

- (ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, or 303; and
- (iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under section 1122(b)); and
- **(D)** with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under section 507(a)(8), but for the secured status of that claim, the holder of that claim will receive on account of that claim, cash payments, in the same manner and over the same period, as prescribed in subparagraph (C).
- (10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.
- (11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.
- (12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.
- (13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.
- (14) If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.
- (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan--
 - (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
 - **(B)** the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.
- (16) All transfers of property under the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.

§ 1129. Confirmation of plan, 11 USCA § 1129

- **(b)(1)** Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.
- (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
 - (A) With respect to a class of secured claims, the plan provides--
 - (i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
 - (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
 - (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
 - (iii) for the realization by such holders of the indubitable equivalent of such claims.
 - (B) With respect to a class of unsecured claims--
 - (i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or
 - (ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.
 - (C) With respect to a class of interests--
 - (i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

§ 1129. Confirmation of plan, 11 USCA § 1129

- (ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.
- (c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.
- (d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.
- (e) In a small business case, the court shall confirm a plan that complies with the applicable provisions of this title and that is filed in accordance with section 1121(e) not later than 45 days after the plan is filed unless the time for confirmation is extended in accordance with section 1121(e)(3).

CREDIT(S)

(Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2635; Pub.L. 98-353, Title III, § 512, July 10, 1984, 98 Stat. 386; Pub.L. 99-554, Title II, §§ 225, 283(v), Oct. 27, 1986, 100 Stat. 3102, 3118; Pub.L. 100-334, § 2(b), June 16, 1988, 102 Stat. 613; Pub.L. 103-394, Title III, § 304(h)(7), Title V, § 501(d)(32), Oct. 22, 1994, 108 Stat. 4134, 4146; Pub.L. 109-8, Title II, § 213(1), Title III, § 321(c), Title IV, § 438, Title VII, § 710, Title XII, § 1221(b), Title XV, § 1502(a)(8), Apr. 20, 2005, 119 Stat. 52, 95, 113, 127, 196, 216; Pub.L. 111-327, § 2(a)(35), Dec. 22, 2010, 124 Stat. 3561.)

Notes of Decisions (1859)

Footnotes

1 No value.

11 U.S.C.A. § 1129, 11 USCA § 1129

Current through P.L. 117-145. Some statute sections may be more current, see credits for details.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Mallinckrodt PLC, Bankr.D.Del., February 8, 2022
636 B.R. 641

United States District Court, E.D. Virginia, Richmond Division.

Joel PATTERSON, et al., Appellants,

V.

MAHWAH BERGEN RETAIL GROUP, INC., Appellee.

Civil No. 3:21cv167 (DJN) | | Signed 01/13/2022

Synopsis

Background: United States Trustee, as well as lead plaintiffs designated in putative class action alleging securities fraud, appealed from order of the United States Bankruptcy Court for the Eastern District of Virginia, Kevin R. Huennekens, J., confirming debtors' joint Chapter 11 plan, challenging the plan's broad third-party releases and exculpation provision.

Holdings: The District Court, David J. Novak, J., held that:

- [1] United States Trustee had standing to appeal Bankruptcy Court's order confirming debtors' joint Chapter 11 plan;
- [2] lead plaintiffs lacked standing to appeal Bankruptcy Court's order;
- [3] Bankruptcy Court failed to identify whether it had jurisdiction over claims in plan's broad third-party releases;
- [4] Bankruptcy Court lacked jurisdiction over broadly released claims between non-debtors that had no connection to property of the estate or administration of the bankruptcy proceeding;
- [5] Bankruptcy Court lacked knowing and voluntary consent of releasing parties in approving broad third-party, non-debtor releases;
- [6] notice and opt-out forms with respect to third-party, nondebtor releases failed to afford due process;

- [7] Bankruptcy Court's erred in failing to analyze factors under *Behrmann v. National Heritage Foundation*, 663 F.3d 704, when approving broad third-party, non-debtor releases;
- [8] third-party, non-debtor releases failed to satisfy factors for approval of releases under *Behrmann*; and
- [9] exculpation provision in Chapter 11 plan impermissibly extended beyond fiduciaries who performed necessary and valuable duties.

Vacated and remanded

West Headnotes (111)

[1] Constitutional Law - Notice and Hearing

Central meaning of "procedural due process" is that parties whose rights are to be affected are entitled to be heard and, in order that they may enjoy that right, they must first be notified. U.S. Const. Amend. 5.

[2] Constitutional Law 🦫 Notice

Due process guarantee of the right to be heard has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest, U.S. Const. Amend. 5.

[3] Compromise, Settlement, and Release - Nonparties in general

Parties who choose to resolve litigation through settlement may not dispose of the claims of a third party, and a fortiori may not impose duties or obligations on a third party, without that party's agreement, because general rule provides that a person cannot be deprived of his legal rights in a proceeding to which he is not a party.

[4] Bankruptcy 🧽 Scope of review in general

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

When reviewing a decision of the bankruptcy court rendered in a core proceeding, a district court functions as an appellate court and applies the standards of review in federal courts of appeal.

[5] Bankruptcy • Conclusions of law; de novo review

District court reviews the bankruptcy court's legal conclusions de novo.

[6] Bankruptcy 🤛 Clear error

District court reviews the bankruptcy court's factual findings for clear error.

[7] Bankruptcy 🧽 Clear error

In reviewing bankruptcy court's decision, clear error exists when the district court is left with the definite and firm conviction that a mistake has been committed.

[8] Bankruptcy Conclusions of law; de novo review

Bankruptcy 🧽 Clear error

In cases involving questions of law and fact, the district court reviews the bankruptcy court's findings of fact under the clearly erroneous standard and reviews de novo the legal conclusions derived from those facts.

[9] Bankruptcy - Conclusions of law; de novo review

If proceeding before bankruptcy court constitutes a non-core proceeding and the parties did not consent to the bankruptcy court's jurisdiction, the district court undertakes de novo analysis of both factual findings to which appellant objected and the law.

[10] **Bankruptcy** A Right of review and persons entitled; parties; waiver or estoppel

United States Trustee had standing to appeal Bankruptcy Court's order confirming debtors' joint Chapter 11 plan, challenging the plan's broad third-party releases and exculpation provision. 11 U.S.C.A. § 307.

[11] **Bankruptcy** • Powers, Duties and Fiduciary Capacity

United States Trustee serves the role of protecting the public interest and ensuring that bankruptcy cases are conducted according to law. 11 U.S.C.A. § 307.

[12] **Bankruptcy** \leftarrow Right of review and persons entitled; parties; waiver or estoppel

To have standing to appeal a bankruptcy court's order to the district court, appellant must be a "person aggrieved" by the bankruptcy order.

[13] Bankruptcy Right of review and persons entitled; parties; waiver or estoppel

To be "person aggrieved" with standing to appeal a bankruptcy court's order, appellant must show that the order diminishes its property, increases its burdens, or impairs its rights.

[14] Bankruptcy & Right of review and persons entitled; parties; waiver or estoppel

Securities litigation lead plaintiffs' capacity as putative class representatives did not confer standing to appeal Bankruptcy Court's order confirming debtors' joint Chapter 11 plan, challenging the plan's broad third-party releases and exculpation provision.

[15] Federal Civil Procedure Representation of class; typicality; standing in general

Class representative is an agent only if the class is certified. Fed. R. Civ. P. 23; Fed. R. Bankr. P. 7023.

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

[16] **Bankruptcy** \leftarrow Right of review and persons entitled; parties; waiver or estoppel

Speculation and conjecture do not give rise to bankruptcy appellate standing.

[17] **Bankruptcy** A Right of review and persons entitled; parties; waiver or estoppel

Lead plaintiffs designated in putative class action alleging securities fraud lacked standing to appeal Bankruptcy Court's order confirming debtors' joint Chapter 11 plan, challenging the plan's broad third-party releases and exculpation provision; by objecting to the third-party releases, the securities litigation lead plaintiffs opted out of the release, and therefore it had no impact on them, and they lacked standing to challenge the third-party releases on behalf of others who were not parties.

[18] Bankruptcy Withdrawal or transfer to district court

District courts retain the authority to withdraw, in whole or in part, any case or proceeding that they referred to a bankruptcy court. 28 U.S.C.A. § 157(d).

[19] Bankruptcy Bankruptcy courts and other federal courts

While district courts were given jurisdiction over bankruptcy cases, Congress also delegated to the bankruptcy courts, as judicial officers of the district courts, adjudicatory authority, subject to the district courts' supervision and the limits imposed by the Constitution. U.S. Const. art. 3, § 1; 28 U.S.C.A. §§ 157, 1334.

[20] Judges Ferm and tenure of office in general

District courts and Courts of Appeals are composed of judges who enjoy the protections

of Article III, namely, life tenure and pay that cannot be diminished. U.S. Const. art. 3, § 1.

[21] Judges Term and tenure of office in general

Protections of life tenure and against salary diminution that Article III provides help to ensure the integrity and independence of the Judiciary. U.S. Const. art. 3, § 1.

[22] Bankruptcy Core, Non-Core, or Related Proceedings in General; Nexus

Bankruptcy proceedings are divided into three categories: (1) those that arise under title 11, (2) those that arise in a title 11 case, and (3) those that are related to a case under title 11. 28 U.S.C.A. §§ 157, 1334.

[23] Bankruptcy Core or non-core proceedings Proceedings that arise under title 11 or arise in a title 11 case constitute "core" proceedings, for purposes of bankruptcy jurisdiction. 28 U.S.C.A.

§§ 157, 1334.

Bankruptcy ← Core or non-core proceedings Bankruptcy judge has the statutory authority to hear and enter final judgments in core proceedings. 28 U.S.C.A. §§ 157, 1334.

[25] Bankruptcy Core or non-core proceedings Bankruptcy courts only have the constitutional authority to adjudicate core claims, even

authority to adjudicate core claims, even if Congress has granted them the statutory authority to resolve other claims; this constitutional limitation applies to a bankruptcy court's authority to grant releases. U.S. Const. art. 3, § 1 et seq.; 28 U.S.C.A. §§ 157, 1334.

[26] Bankruptcy 🧽 Core or non-core proceedings

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

Bankruptcy court has responsibility to properly classify claims before it as core or non-core based on content of claims and adjudicate them according to those classifications. 28 U.S.C.A. §§ 157, 1334.

[27] Bankruptcy Core or non-core proceedings

Cause of action is constitutionally core when it stems from bankruptcy itself or would necessarily be resolved in claims allowance process. U.S. Const. art. 3, § 1 et seq.; 28 U.S.C.A. §§ 157, 1334.

[28] Bankruptcy — Counterclaims

Bankruptcy estate's claim against creditor would necessarily be resolved in claims allowance process, and thus would be constitutionally core, when it shares common questions of fact and law with creditor's claims and when it seeks to directly reduce or recoup amount claimed. U.S. Const. art. 3, § 1 et seq.; 28 U.S.C.A. §§ 157, 1334.

[29] Bankruptcy E Core or non-core proceedings

Claim can become core, and thus be heard by bankruptcy judge under title 11, when it becomes integral to restructuring of debtor-creditor relationship. 28 U.S.C.A. §§ 157, 1334.

[30] Bankruptcy - Core or related proceedings

Claims by the bankruptcy estate that seek to augment the estate but do not directly modify the amount claimed do not qualify as a core claim to be resolved in ruling on the proof of claim. 28 U.S.C.A. §§ 157, 1334.

[31] Bankruptcy Submission to district court for judgment

When confronted with a so-called *Stern* claim, a claim designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as

a constitutional matter, the bankruptcy court should proceed with the claim as it would for non-core claims and determine whether the claim is otherwise related to a case under title 11, and if it is, then hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment. U.S. Const. art. 3, § 1 et seq.; 28 U.S.C.A. §§ 157, 1334.

1 Cases that cite this headnote

[32] Bankruptcy Core or non-core proceedings

Courts should focus on the content of the proceeding rather than the category of the proceeding as core or non-core when determining whether a bankruptcy court has acted within its constitutional authority. U.S. Const. art. 3, § 1 et seq.; 28 U.S.C.A. §§ 157, 1334.

1 Cases that cite this headnote

[33] Bankruptcy Core, Non-Core, or Related Proceedings in General: Nexus

Bankruptcy Settlement, adjustment, or enforcement of claims

In confirming debtors' joint Chapter 11 plan, Bankruptcy Court failed to identify whether it had jurisdiction over claims in plan's broad third-party releases; court did not parse the content of the claims that it purported to release to determine if each claim constituted a core claim, a non-core claim or a claim unrelated to the bankruptcy case, and enormity of the task did not absolve the court of its responsibility to properly identify the content of the claims before it and ensure that it had jurisdiction to rule on each of them. 28 U.S.C.A. §§ 157, 1334.

1 Cases that cite this headnote

[34] Bankruptcy ← Issues between non-debtors Bankruptcy ← Settlement, adjustment, or enforcement of claims

In confirming debtors' joint Chapter 11 plan, Bankruptcy Court lacked jurisdiction over broadly released claims between non-debtors

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

that had no connection to the property of the bankruptcy estate or the administration of the bankruptcy proceeding, including third-party release that would bar securities claims against former directors and officers of debtor, even if the claims arose before debtor filed for bankruptcy and those directors and officers had no involvement in the bankruptcy proceeding, and hostile work environment claims by a former employee of debtor against another employee, and breach of contract action by an accountant of one of debtor's loan agents against the agent for failure to pay for work performed on the agent's transaction with debtor. U.S. Const. art. 3, § 1 et seq.; 28 U.S.C.A. §§ 157, 1334.

[35] Indemnity 🧽 Contract liability

Federal courts disfavor indemnity for federal securities law violations, calling into question the enforceability of these obligations.

[36] Bankruptcy - Conclusiveness

Once Chapter 11 plan became final, the provisions therein, including broad third-party releases, became res judicata for subsequent parties trying to bring the claims.

[37] Bankruptcy Carrying out provisions of Code

Although Bankruptcy Code permits bankruptcy court to issue orders necessary or appropriate to carry out provisions of Code, that does not provide independent source of federal subject matter jurisdiction. 11 U.S.C.A. § 105.

[38] Bankruptcy Determination of jurisdictional questions

Independent statutory basis must exist for bankruptcy court to exercise jurisdiction over claims.

[39] Bankruptcy Limited, in personam, and in rem jurisdiction

Without independent source of jurisdiction, bankruptcy court must rely on its own jurisdiction, which comes in form of in rem jurisdiction over debtor's property and disposition of that property.

[40] Bankruptcy - Equitable powers and principles

Bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.

[41] Bankruptcy Rights of Action; Contract Rights Generally

Third-party claims belong to third parties, not the debtor's estate. 11 U.S.C.A. § 541.

[42] Bankruptcy 🤛 Bankruptcy Jurisdiction

As a general rule, a bankruptcy court has no power to say what happens to property that belongs to a third party, even if that third party is a creditor or otherwise is a party in interest.

[43] Bankruptcy Limited, in personam, and in rem jurisdiction

Although bankruptcy court's in rem jurisdiction gives it authority over claims against the estate, it has no in rem jurisdiction over third-party claims not against estate or property of estate.

[44] Bankruptcy 💝 Issues between non-debtors

Article III does not allow third-party non-debtors to bootstrap any and all of their disputes into a bankruptcy case to obtain relief. U.S. Const. art. 3, § 1 et seq.

[45] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

Bankruptcy Court's determination that releasing parties received notice and an opportunity to opt out of third-party releases in debtors' joint Chapter 11 plan, in context of whether releasing parties consented to the third-party releases, could not support a finding of consent to having the Bankruptcy Court adjudicate the released claims.

[46] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Courts can discern the implication of consent to adjudication by non-Article III court based on a party's actions, however, a finding of consent based on inaction is not permitted. U.S. Const. art. 3, § 1 et seq.

[47] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Bankruptcy Court lacked knowing and voluntary consent of releasing parties in approving broad third-party, non-debtor releases when confirming debtors' joint Chapter 11 plan.

[48] Bankruptey • Conclusions of law; de novo review

Where Bankruptcy Court exceeded its authority in approving broad third-party, non-debtor releases when confirming debtors' joint Chapter 11 plan, District Court would vacate the confirmation order and treat it as a report and recommendation with proposed findings of fact and conclusions of law, which the District Court would review de novo. 28 U.S.C.A. § 157(c)(1); Fed. R. Bankr. P. 8018.1.

[49] Bankruptcy Confirmation; Objections Bankruptcy Particular cases and issues

Where Bankruptcy Court's decision confirming debtors' joint Chapter 11 plan lacked any meaningful factfinding, District Court reviewing

the decision would set forth its own factual findings based on the record from the confirmation hearing. Fed. R. Bankr. P. 9033(d).

[50] Bankruptcy Submission to district court for judgment

Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy court should submit any thirdparty releases to the district court for approval via a report and recommendation in the rare and exceptional case that warrants the use of third-party releases, identifying with specificity the claims and individuals released and provide detailed proposed findings of fact and conclusions of law to ensure that the released claims are truly integral to the reorganization.

[51] Bankruptcy Settlement, adjustment, or enforcement of claims

Use of third-party releases in confirming Chapter 11 plans should be utilized cautiously and infrequently.

[52] Bankruptcy Settlement, adjustment, or enforcement of claims

Third-party release is not a merit badge that somebody gets in return for making a positive contribution to a restructuring; it is not a participation trophy nor a gold star for doing a good job.

[53] Bankruptcy Settlement, adjustment, or enforcement of claims

Nonconsensual releases should not be granted by bankruptcy court unless barring a particular claim is important in order to accomplish a particular feature of the restructuring.

[54] Bankruptcy Settlement, adjustment, or enforcement of claims

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

When the following seven factors are present pursuant to Behrmann v. National Heritage Foundation, 663 F.3d 704, bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor: (1) there is an identity of interests between debtor and third party, usually an indemnity relationship, such that a suit against non-debtor is, in essence, a suit against debtor or will deplete estate assets, (2) non-debtor has contributed substantial assets to the reorganization, (3) injunction is essential to reorganization, namely, reorganization hinges on debtor being free from indirect suits against parties who would have indemnity or contribution claims against debtor, (4) impacted class, or classes, has overwhelmingly voted to accept plan, (5) plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction, (6) plan provides an opportunity for those claimants who choose not to settle to recover in full and, (7) court made a record of specific factual findings that support its conclusions.

[55] Bankruptcy 🧽 Confirmation; Objections

Given the dramatic effect of third-party releases and that they are to be approved only in unique circumstances, the meaningful exercise of appellate review at a minimum requires that the court make specific factual findings in support of its decision to grant equitable relief.

[56] Bankruptcy 🧽 Confirmation; Objections

The exacting caution and detailed findings demanded of a bankruptcy court in granting a non-debtor release in a unique circumstance stems from the constitutional limitations placed on the bankruptcy court's jurisdiction. U.S. Const. art. 3, § 1 et seq.

[57] Bankruptcy 🧽 Bankruptcy judges

Constitution limits bankruptcy courts, as non-Article III courts, to adjudicating only matters integral to bankruptcy proceeding. U.S. Const. art. 3, § 1.

[58] Bankruptcy — Settlement, adjustment, or enforcement of claims

Factors for determining whether to allow nondebtor releases task a reviewing court with determining how integral the releases are to a bankruptcy plan.

[59] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy 🧽 Confirmation; Objections

Bankruptcy Court's lack of explanation supporting approval of broad third-party, non-debtor releases when confirming debtors' joint Chapter 11 plan was clear error; instead of making detailed factual findings as to whether unique circumstances warranted the inclusion of non-debtor releases, Bankruptcy Court stated in conclusory fashion that the third-party releases were integral to the plan.

2 Cases that cite this headnote

Bankruptcy Settlement, adjustment, or enforcement of claims

Failing to opt out did not rise to the level of consent required to obviate analysis of seven factors under *Behrmann v. National Heritage Foundation*, 663 F.3d 704, for approving third-party, non-debtor releases in debtors' joint Chapter 11 plan.

[61] Federal Civil Procedure Factors, grounds, objections, and considerations in general Federal Civil Procedure Poptions;

withdrawal

Courts, notably, Article III judges, may bind absent class members to a judgment so long as they provide them notice of the action and the opportunity to either opt out or participate, but to do so, courts must ensure that the class action complies with the unique requirements of rule governing class actions. U.S. Const. art. 3, § 1; Fed. R. Civ. P. 23.

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

[62] Bankruptcy 🤛 Parties

Court must appoint class counsel to represent the class, as pro se litigants cannot represent absent class members. Fed. R. Civ. P. 23; Fed. R. Bankr. P. 7023.

[63] Bankruptcy 🕪 Parties

Presiding court bears responsibility for ensuring compliance with all of the requirements for class actions. Fed. R. Civ. P. 23; Fed. R. Bankr. P. 7023.

[64] Bankruptcy Sea Parties

Bankruptcy 🤛 Judicial authority or approval

Any class settlement that would bind absent class members requires court approval. Fed. R. Civ. P. 23(e); Fed. R. Bankr. P. 7023.

[65] Bankruptcy 🧽 Parties

Bankruptcy — Judicial authority or approval

Inquiry appropriate under rule prohibiting compromise of class action without approval of court and notice to all class members protects unnamed class members from unjust or unfair settlements affecting their rights. Fed. R. Civ. P. 23(e); Fed. R. Bankr. P. 7023.

[66] Bankruptcy 距 Parties

Constitutional Law 🗽 Class Actions

To satisfy due process in class action, notice must be best practicable, reasonably calculated, under all circumstances, to apprise interested parties of pendency of action and afford them opportunity to present their objections; the notice should describe the action and the plaintiffs' rights in it; absent plaintiff must be provided with an opportunity to remove himself from the class by executing and returning an "opt out" or "request for exclusion" form to the court; and named plaintiff must at all times adequately represent the interests of the absent class members. U.S.

Const. Amend. 5; Fed. R. Civ. P. 23; Fed. R. Bankr. P. 7023.

Bankruptcy Settlement, adjustment, or enforcement of claims

Constitutional Law 🗽 Class Actions

Notice and opt-out forms with respect to thirdparty, non-debtor releases in debtors' joint Chapter 11 plan, which did not describe the released claims or the rights given up by the absent releasing parties, failed to afford due process. U.S. Const. Amend. 5.

[68] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy 🧽 Confirmation; Objections

Because only cases with unique circumstances warrant granting nonconsensual non-debtor releases, bankruptcy court must make specific factual findings demonstrating why debtor's circumstances entitle it to the benefit of the releases.

[69] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy 🧽 Confirmation; Objections

Bankruptcy Court's erred in failing to analyze seven factors under Behrmann v. National Heritage Foundation, 663 F.3d 704, when approving broad third-party, non-debtor releases in debtors' joint Chapter 11 plan, and instead, stating only in a single footnote that if the Behrmann factors were applicable to the third-party releases, the court would find the factors were satisfied for the reasons stated in debtors' memorandum of law; such a cursory consideration of the Behrmann factors disregarded the Fourth Circuit's command to limit the use of third-party releases to the exceptional case warranting them, and District Court could not conduct meaningful appellate review as a result of the Bankruptcy Court's failure to address that which had been released.

[70] Bankruptcy Settlement, adjustment, or enforcement of claims

Court may not satisfy its judicial responsibilities under *Behrmann v. National Heritage Foundation*, 663 F.3d 704, to make specific factual findings demonstrating that nonconsensual non-debtor release is warranted by simply incorporating by reference party's brief.

[71] **Bankruptcy** Settlement, adjustment, or enforcement of claims

Broad third-party, non-debtor releases in debtors' joint Chapter 11 plan, including claims in putative class action alleging securities fraud, failed to satisfy factors for approval of releases under Behrmann v. National Heritage Foundation, 663 F.3d 704, warranting voiding the releases; fact that defendants provided releases to debtors did not amount to a substantial contribution of assets, especially given the illusory nature of the releases, debtors largely liquidated, rather than reorganized, which cut against the essential nature of the releases, plan would not be doomed if defendants did not obtain a release, and plan did not create a separate fund to pay the claims released or provide any other mechanism to consider or pay the securities claims.

[72] Bankruptcy - Injunction or stay of other proceedings

Granting permanent injunctions to protect nondebtor parties on basis of theoretical identity of interest alone would turn bankruptcy principles on their head; nothing in Bankruptcy Code can be construed to establish such extraordinary protection for non-debtor parties.

[73] Bankruptcy Settlement, adjustment, or enforcement of claims

Debtor must demonstrate that non-debtor release is essential to its reorganization, as factor for approval of release pursuant to *Behrmann v*.

National Heritage Foundation, 663 F.3d 704, such that the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor.

[74] **Bankruptcy** Construction, execution, and performance

Third-party, non-debtor releases in debtors' joint Chapter 11 plan that were voided on appeal from Bankruptcy Court's confirmation order could be severed from the plan by District Court, despite nonseverability provision of plan stating that Bankruptcy Court could sever any provision before confirmation without it affecting the rest of the plan, but after confirmation all provisions were integral and only debtors could consent to severance of a particular provision; since District Court had found a Stern violation and vacated the confirmation order, the plan was before the District Court as proposed findings of fact and conclusions of law and the District Court stepped into the shoes of the Bankruptcy Court, such that first half of the nonseverability provision remained the operative provision. Fed. R. Bankr. P. 8018.1.

[75] Bankruptcy - Settlement, adjustment, or enforcement of claims

Bankruptcy \leftarrow Construction, execution, and performance

Severing voided third-party, non-debtor releases in debtors' joint Chapter 11 plan after Bankruptcy Court's confirmation order was vacated was appropriate; nonseverability provision expressly provided that, before confirmation, the Bankruptcy Court could find the third-party releases, or any provision, unenforceable, and in the event of such a holding, the plan would in no way be affected, impaired, or invalidated, and nonseverability provision also provided that a provision of the plan could be deleted with debtors' consent, which demonstrated that the third-party releases were not inextricably tied to the rest of the plan and that the plan could survive in the absence of any particular provision, and

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

there was no evidence as to why the court could not excise the third-party releases without seriously threatening debtors' ability to reemerge successfully from bankruptcy, as debtors made clear the plan had been substantially consummated.

2 Cases that cite this headnote

[76] Bankruptcy Construction, execution, and performance

In determining severability of provision from plan, courts must look to the evidence in the record and not simply whether the parties state in a conclusory fashion that the provision cannot be severed.

[77] Bankruptcy 🤛 Moot questions

Normally a nonseverability clause standing on its own cannot support a finding of equitable mootness.

[78] Bankruptcy 🕪 Moot questions

While a nonseverability clause may be one indication that a particular term was important to the bargaining parties, a district court cannot rely on such a clause to the exclusion of other evidence to support a finding of equitable mootness.

[79] Statutes & Effect of Partial Invalidity; Severability

When confronted with an unconstitutional provision in a statute, courts typically sever any problematic portions while leaving the remainder intact.

[80] Bankruptcy Construction, execution, and performance

Presumption of severability operates in the presence or absence of a severability provision in bankruptcy plan.

[81] Statutes & Effect of Partial Invalidity; Severability

In evaluating severability of unconstitutional provision in a statute, courts inquire whether the statute will function in a manner consistent with the intent of Congress without the unconstitutional provision.

[82] Statutes ← Effect of Partial Invalidity; Severability

If unconstitutionality of part of statute does not necessarily defeat or affect validity of its remaining provisions, then courts will invalidate only unconstitutional portion.

[83] Statutes ← Effect of Partial Invalidity; Severability

In evaluating severability of unconstitutional provision in a statute, courts look to whether severing the offending provision would upend the entire statute and, if not, they default to severing the provision.

[84] Contracts 🧽 Partial Illegality

Under Virginia law, generally, when contract covers several subjects, some of whose provisions are valid and some void, those which are valid will be upheld if they are not so interwoven with those illegal as to make divisibility impossible.

[85] Contracts & Partial Illegality

Under Delaware law, invalid term of otherwise valid contract, if severable, will not defeat contract.

[86] Contracts — Certainty as to Subject-Matter

Under Delaware law, court will enforce contract with indefinite provision if provision is not material or essential term.

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

[87] Contracts 🧽 Partial Illegality

When faced with unenforceable provision in contract, courts will look to whether severing provision will upset entire contract.

[88] Bankruptcy - Moot questions

Equitable mootness is pragmatic doctrine grounded in notion that, with passage of time after judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable.

[89] Bankruptcy • Moot questions

Application of equitable mootness doctrine is based on practicality and prudence, does not employ rigid rules, and requires that court determine whether judicial relief on appeal can, as pragmatic matter, be granted.

[90] Bankruptcy 🌦 Moot questions

In determining whether equitable mootness doctrine applies, courts can examine the following relevant factors: (1) whether appellant sought and obtained stay; (2) whether reorganization plan or other equitable relief has been substantially consummated; (3) extent to which relief requested on appeal would affect success of reorganization plan or other equitable relief granted; and (4) extent to which relief requested on appeal would affect interests of third parties.

1 Cases that cite this headnote

[91] Bankruptcy • Moot questions

Reviewing court has discretion whether to find an appeal equitably moot.

1 Cases that cite this headnote

[92] Bankruptcy • Moot questions

Equitable mootness applies to specific claims, not entire appeals and must be applied with a scalpel rather than an axe.

[93] Bankruptcy 🧽 Moot questions

Equitable mootness doctrine did not apply to prevent District Court from hearing appeal by United States Trustee (UST) and lead plaintiffs designated in putative class action alleging securities fraud from Bankruptcy Court's order confirming debtors' joint Chapter 11 plan and approving broad third-party, non-debtor releases; finding of equitable mootness would preclude UST, who was seeking to protect rights of absent individuals, from fulfilling duty of protecting public interest and preventing abuse of the bankruptcy system, seriousness of Bankruptcy Court's errors in extinguishing claims of absent and nonconsenting parties without constitutional authority to adjudicate those claims directly concerned integrity of the bankruptcy process, and requested relief of invalidating all or parts of releases would only prospectively affect ability of parties to bring suits based on past events and would require no unwinding. U.S. Const. art. 3, § 1 et seq.

[94] Bankruptcy 🧽 Moot questions

Equitable mootness doctrine applies especially when a party, seeking a return to the status quo ante, sits idly by and permits intervening events to extinguish old rights and create new ones.

[95] Equity - Grounds of jurisdiction in general

When the public interest rather than private rights are at stake, equitable doctrines take on a different role in favor of protecting the public interests.

[96] Federal Courts Right to Decline Jurisdiction; Abstention

An Article III appellate court has a virtually unflagging obligation to exercise its subject matter jurisdiction. U.S. Const. art. 3, § 1 et seq.

2022 SOUTHEAST BANKRUPTCY WORKSHOP

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

[97] Bankruptcy 🧽 Moot questions

Equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process.

[98] Bankruptcy 🧽 Moot questions

In determining whether equitable mootness applies, when relief requested does not seek to undo any aspect of confirmed plan that has been consummated, it would not be impractical, imprudent, or inequitable to allow the appeal to proceed.

[99] Bankruptcy Compromises, Releases, and Stipulations

In contrast to third-party releases that offer protection to non-debtors for pre-confirmation liability, an exculpation provision serves to protect court professionals who act reasonably while carrying out their responsibilities in connection with the bankruptcy case.

[100] Bankruptcy Settlement, adjustment, or enforcement of claims

Exculpation provisions in Chapter 11 plans do not release parties, but instead raise the liability standard of fiduciaries for their conduct during their case.

[101] Bankruptcy Settlement, adjustment, or enforcement of claims

Exculpation provisions in Chapter 11 plans generally are permissible, so long as they are properly limited and not overly broad.

[102] Bankruptcy Settlement, adjustment, or enforcement of claims

Court will approve an exculpation provision in Chapter 11 plan so long as it is limited to those parties who have served the debtor, is narrowly tailored and complies with the applicable standards.

[103] Bankruptcy Settlement, adjustment, or enforcement of claims

Exculpation provision is appropriate when it is solely limited to fiduciaries who have served a debtor through a Chapter 11 proceeding.

[104] Bankruptcy & Leave to sue

Under *Barton* rule, *Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672, party cannot bring a suit against a bankruptcy trustee or the trustee's attorneys for acts within the trustee's duties of recovering assets for the estate without first obtaining leave of court.

[105] Bankruptcy 🐎 Leave to sue

The *Barton* doctrine, *Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672, whereby party cannot bring suit against trustee or trustee's attorneys for acts within trustee's duties of recovering assets for the estate without first obtaining leave of court, serves the principle that a bankruptcy trustee is an officer of the court that appoints him and therefore that court has a strong interest in protecting him from unjustified personal liability for acts taken within the scope of his official duties.

[106] Bankruptcy Creditors' and equity security holders' committees and meetings

Limited granted of immunity under bankruptcy statute governing powers and duties of committees covers committee members for actions within the scope of their duties. 11 U.S.C.A. § 1103(c).

[107] Bankruptcy Settlement, adjustment, or enforcement of claims

Proper exculpation provision in Chapter 11 plan is protection not only of court-supervised

AMERICAN BANKRUPTCY INSTITUTE

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

fiduciaries, but also of court-supervised and court-approved transactions.

financial advisors and consultants of every party being exculpated.

[108] Bankruptcy Settlement, adjustment, or enforcement of claims

Narrowly tailored exculpation provision in Chapter 11 plan serves only those aims of protecting parties who have performed necessary duties in connection with case.

[109] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy Court did not err by failing to apply factors for approving third-party, non-debtor releases under *Behrmann v. National Heritage Foundation*, 663 F.3d 704 to exculpation provision when the court approved debtors' joint Chapter 11 plan.

[110] Bankruptcy Settlement, adjustment, or enforcement of claims

Exculpation provision in Chapter 11 plan that is limited to those parties who have served the debtor is narrowly tailored and complies with the applicable standards must contain the following limitations: (1) it must be limited to the fiduciaries who have performed necessary and valuable duties in connection with the bankruptcy case; (2) is limited to acts and omissions taken in connection with the bankruptcy case; (3) does not purport to release any pre-petition claims; (4) contains a carve out for gross negligence, actual fraud or willful misconduct; and (5) contains a gatekeeper function.

[111] Bankruptcy Settlement, adjustment, or enforcement of claims

Exculpation provision in debtors' joint Chapter 11 plan impermissibly extended beyond fiduciaries who performed necessary and valuable duties, to include all current and former employees, attorneys, accountants, managers,

Attorneys and Law Firms

*652 Ronald Allen Page, Jr., Ronald Page, PLC, N. Chesterfield, VA, John Phillip Schneider, Pro Hac Vice, Lowenstein Sandler LLP, New York, NY, Andrew David Behlmann, Pro Hac Vice, Michael Seth Etkin, Pro Hac Vice, Michael Papandrea, Pro Hac Vice, Lowenstein Sandler LLP, Roseland, NJ, for Appellants Joel Patterson, Michaella Corporation.

Kathryn R. Montgomery, United States Department of Justice Office of the United States Trustee, Richmond, VA, Hugh Michael Bernstein, Pro Hac Vice, US Department of Justice, Baltimore, MD, Sumi Sakata, Pro Hac Vice, United States Department of Justice, Washington, DC, for Appellant John P. Fitzgerald.

Cullen Drescher Speckhart, Pro Hac Vice, Cooley LLP, Andrew C. Lawrence, Pro Hac Vice, George Hicks, Jr., Pro Hac Vice, Kirkland & Ellis LLP, Washington, DC, John R. Luze, Pro Hac Vice, Kirkland & Ellis LLP, Chicago, IL, for Appellee.

MEMORANDUM OPINION

David J. Novak, United States District Judge

*653 This case arises out of the bankruptcy cases commenced by Mahwah Bergen Retail Group, Inc. (f/k/a Ascena Retail Group, Inc.) ("Mahwah" or "Ascena") and sixty-three of its affiliates (collectively, the "Debtors"). The United States Bankruptcy Court for the Eastern District of Virginia ("Bankruptcy Court") confirmed the reorganization plan ("the Plan") set forth by the parties in interest, and Joel Patterson and Michaella Corporation ("Securities Litigation Lead Plaintiffs") filed notices of appeal to this Court. Likewise, the United States Trustee ("Trustee") filed a notice of appeal of the confirmation to this Court. ¹ The appeals were consolidated into this action. ² In these appeals, Appellants challenge third-party (non-debtor) releases, as well as an exculpation provision, contained in the Plan.

right guaranteed by the due process clause in our judicial system: the right to be heard before the loss of one's rights. "For more than a century the central meaning of procedural due process has been clear: 'Parties whose rights are to be affected are entitled to be heard; and in order that they may enjoy that right they must first be notified.' "Fuentes v. Shevin, 407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) (quoting Baldwin v. Hale, 68 U.S. 1 Wall. 223, 233, 17 L.Ed. 531 (1863)). "And, the Supreme Court has explained that the particular constitutional protection afforded by access to the courts is 'the right conservative of all other rights, and lies at the foundation of orderly government." "Cromer v. Kraft Foods N. Am., Inc., 390 F.3d 812, 817 (4th Cir. 2004) (quoting Chambers v. Baltimore & O. R. Co., 207 U.S. 142, 148, 28 S.Ct. 34, 52 L.Ed. 143 (1907)). Furthermore, "[t]his right ... has little reality or worth unless one is informed that the matter is pending and can choose for himself whether to appear or default, acquiesce or contest." Schroeder v. City of New York, 371 U.S. 208, 212, 83 S.Ct. 279, 9 L.Ed.2d 255 (1962) (quoting Mullane v. Cent. Hanover Bank & Tr. Co., 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950)). Relatedly, "parties who choose to resolve litigation through settlement may not dispose of the claims of a third party, and a fortiori may not impose duties or obligations on a third party, without that party's agreement." Loc. No. 93, Int'l Ass'n of Firefighters AFL-CIO C.L.C. v. City of Cleveland, 478 U.S. 501, 529 (1986). This is so, because the general rule provides "that a person cannot be deprived of his legal rights in a proceeding *654 to which he is not a party." *Martin v.* Wilks, 490 U.S. 755, 759, 109 S.Ct. 2180, 104 L.Ed.2d 835 (1989); see also id. at 762, 109 S.Ct. 2180 ("A judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings.").

These fundamental principles resonate with force in this appeal from the Bankruptcy Court, as third-party releases strike at the heart of these foundational rights. The United States Trustee — a statutory watchdog over bankruptcy proceedings — and the Securities Litigation Lead Plaintiffs, as designated by a United States District Judge in a putative class action alleging securities fraud, challenge the approval by the Bankruptcy Court³ of exceedingly broad third-party (non-debtor) releases, as well as an exculpation provision, contained in the Plan submitted by Debtors.

Third-party releases, such as those at issue here, carry much controversy, for they are a "device that lends itself to abuse."

[2] [3] This appeal implicates the most fundamental *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2d guaranteed by the due process clause in our judicial state right to be heard before the loss of one's rights. Hore than a century the central meaning of procedural ocess has been clear: 'Parties whose rights are to be dare entitled to be heard; and in order that they may that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.' "Fuentes v. (407 U.S. 67, 80, 92 S.Ct. 1983, 32 L.Ed.2d 556 (1972) that right they must first be notified.'

The Fourth Circuit has made clear that the use of thirdparty releases is disfavored, saying that such releases should be "granted cautiously and infrequently." Behrmann v. Nat'l Heritage Found., 663 F.3d 704, 712 (4th Cir. 2011). Other circuits that permit their use likewise reserve their utilization for the rare or exceptional case. See, e.g., In re Millennium Lab Holdings II, LLC, 945 F.3d 126, 139 (3d Cir. 2019) (directing that "courts considering such releases do so with caution [and] with the utmost care and to thoroughly explain the justification for any such inclusion"); In re Seaside Eng'g & Surveying, Inc., 780 F.3d 1070, 1078 (11th Cir. 2015) (permitting releases and bar orders but cautioning that they "ought not to be issued lightly, and should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts and circumstances"); In re Metromedia Fiber Network, Inc., 416 F.3d at 141-43 (holding that involuntary releases should only be approved if they form an important part in a reorganization plan, and that they are proper "only in rare cases"); In re Dow Corning Corp., 280 F.3d 648, 657-58 (6th Cir. 2002) ("Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a non-consenting creditor's claim is only appropriate in 'unusual circumstances.' ").

Despite these admonitions, the Bankruptcy Court for the Richmond Division of this district regularly approves third-party releases, as acknowledged by Debtors' counsel during oral argument. (Tr. of Dec. 20, 2021 Argument ("Arg. Tr.") at 6:8-14 (ECF No. 75).) This recurrent practice *655 contributes to major companies like Mahwah (a New Jersey company) using the permissive venue provisions of the Bankruptcy Code to file for bankruptcy here. Indeed, according to the Trustee, the Richmond Division (just the division, not the entire Eastern District of Virginia) joins the District of Delaware, the Southern District of New York, and the Houston Division of the Southern District of Texas

as the venue choice for 91% of the "mega" bankruptcy cases. (Reply Br. of Appellant John P. Fitzgerald, III, Acting United States Trustee for Region 4 ("Trustee Reply Br.") at 22-23 (ECF No. 45).) The ubiquity of third-party releases in the Richmond Division demands even greater scrutiny of the propriety of such releases. And, their prevalence also undermines assertions that they are integral to the success of this particular reorganization plan. As District Judge Colleen McMahon astutely observed: "When every case is unique, none is unique." In re Purdue Pharma, L.P., 2021 WL 5979108, at *3.

The Third-Party Releases at issue in this case represent the worst of this all-too-common practice, as they have no bounds. The sheer breadth of the releases can only be described as shocking. They release the claims of at least hundreds of thousands of potential plaintiffs not involved in the bankruptcy, shielding an incalculable number of individuals associated with Debtors in some form, from every conceivable claim — both federal and state claims — for an unspecified time period stretching back to time immemorial. In doing so, the releases close the courthouse doors to an immeasurable number of potential plaintiffs, while protecting corporate insiders who had no role in the reorganization of the company. Yet, the Bankruptcy Court — acting with its limited Article I powers — extinguished these claims with little or no analysis. In doing so, the Bankruptcy Court exceeded the constitutional limits of its authority as delineated by the Supreme Court in Stern v. Marshall, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), ignored the mandates of the Fourth Circuit in Behrmann, and offended the most fundamental precepts of due process.

Likewise, the Bankruptcy Court erred by approving an overly broad Exculpation Provision that exceeds the bounds of similar provisions approved in other cases. However, unlike the Third-Party Releases that must be voided and severed from the reorganization plan, redrafting can salvage the Exculpation Provision on remand.

Accordingly, this case will be remanded to the Bankruptcy Court for further proceedings consistent with this opinion.

I. FACTUAL BACKGROUND⁵

Ascena provided specialty retail apparel for women and girls, operating approximately 2,800 stores in the United States, *656 Canada and Puerto Rico, which served more than 12.5 million customers and employed nearly 40,000 employees. Debtors held a portfolio of recognizable brands, including Ann Taylor, LOFT, Lane Bryant, Catherines, Justice, Lou & Grey and Cacique.

Beginning in March 2020, Debtors had to temporarily close all of their retail stores due to the COVID-19 pandemic, and in so doing, furloughed nearly all of their store-level workforce as well as a substantial portion of their corporate workforce. At the time, Debtors had approximately \$1.6 billion in secured debt and \$700 to \$800 million in unsecured debt. (USTAPP 1592, 1599.) Before filing for bankruptcy, Debtors negotiated with many of their secured lenders to arrive at a restructuring support agreement, which formed the basis of the original chapter 11 plan. (USTAPP 1591.) Then, on July 23, 2020, Debtors commenced the Bankruptcy Cases that ultimately were consolidated into Case No. 20bk33113 in the Bankruptcy Court. However, rather than reorganize, Debtors ultimately largely liquidated the businesses, selling substantially all of the assets for a total sale price of \$651.8 million. (USTAPP 2259-61, 2262-64, 2265-67, 2320.) Thereafter, they filed an amended chapter 11 plan. (Amended Joint Chapter 11 Plan of Reorganization of Mahwah Bergan Retail Group, Inc. and Its Debtor Affiliates (the "Plan") (USTAPP 2410-2529).)

A. The Plan

The Plan provided that some secured lenders would be paid in full, general unsecured creditors would receive pro rata payments from a trust funded by \$7.25 million in cash and the remaining class of secured claims would receive the remainder of Debtors' cash. (USTAPP 2621-36.) The shareholders would receive nothing and the Plan would extinguish their equity interest. (USTAPP 2634.)

On February 25, 2021, the Bankruptcy Court conducted an evidentiary hearing to consider the Debtors' Plan in addition to the unresolved objections filed by the SEC and the Trustee, as well as those raised by Joel Patterson and Michaella Corporation, the lead plaintiffs in a securities fraud action against Ascena and two of its former executives pending in the United States District Court for the District of New Jersey (the "Securities Litigation"). The Bankruptcy Court overruled the objections and confirmed the Plan and, on February 25, 2021, entered the Confirmation Order confirming the Plan. Then, on March 9, 2021, the Bankruptcy Court entered its Memorandum Opinion to supplement its findings of facts and conclusions of law in the Confirmation Order.

Before confirming the Plan, the Bankruptcy Court had to first approve a Disclosure Statement that would supply creditors and interest holders with information about the proposed plan as a part of the solicitation process. Accordingly, on September 10, 2020, the Bankruptcy Court held a hearing regarding the Disclosure Statement. In response to objections by the SEC, the Bankruptcy Court required Debtors to amend the Disclosure Statement to include language recommended by the SEC, so that the notice would more clearly convey information to non-voting equity holders about the provisions of the Plan, including the inclusion of Third-Party Releases, the right of each non-voting equity holder to opt out of the Third-Party Releases and the process for doing so. Additionally, in response to objections by the Securities Litigation Lead Plaintiffs, the Bankruptcy Court adopted additional steps to effectuate notice of the Disclosure Statement. However, the Bankruptcy Court overruled the Trustee's objections, *657 which closely resembled the issues that he raises in this appeal.

The sale of Debtors' brands for \$651 million allowed their brands to continue under new ownership and brought proceeds into Debtors' estate for the benefit of creditors. Debtors' term lenders and the Creditors' Committee endorsed the Plan. The Plan provided for certain payment structures to Debtors' creditors. The unsecured creditors also received a waiver of any avoidance actions that Debtors' estate could bring against them. The holders of equity interest in Ascena were not projected to receive any distribution and, therefore, were deemed to reject the Plan. The Plan also included broad releases that form the basis of this appeal.

B. The Releases Contained in the Plan

As part of the Plan, the major stakeholders negotiated and included extremely broad and convoluted releases and an exculpation provision. Specifically, the Plan provides for the following Debtors' Releases:

[E]ach Released Party is conclusively, absolutely, unconditionally, irrevocably, and forever released and discharged by each and all of the Debtors, the Reorganized Debtors, and their Estates ... from any and all Causes of Action, including any derivative claims, asserted or assertable on behalf of any of the Debtors ... based on or relating to, or in any manner arising from, in whole or in part, the Debtors (including the management, ownership, or operation thereof), the purchase, sale, or rescission of any Security of the Debtors or the Reorganized Debtors, the subject matter of, or the transactions or events giving rise

to, any Claim or Interest that is treated in the Plan,... or any other related agreement, or upon any other act, omission, transaction, agreement, event, or other occurrence (in each case, related to any of the foregoing) taking place on or before the Effective Date.

(USTAPP 2460-61.) The Plan further provides for the following Release by holders of Claims or Interests ("Third-Party Releases"):

Effective as of the Effective Date, each Releasing Party in each case except for Claims arising under, or preserved by, the Plan, Each Releasing Party (other than the Debtors and the Reorganized Debtors), in each case on behalf of itself and its respective successors, assigns, and representatives, and any and all other Entities who may purport to assert any claim, Cause of Action, directly or derivatively, by, through, for, or because of the foregoing entities, is deemed to have released and discharged each Debtor, Reorganized Debtor, and each other Released Party from any and all Causes of Action, whether known or unknown, including any derivative claims, asserted or assertable on behalf of any of the Debtors ... based on or relating to, or in any manner arising from, in whole or in part, the Debtors (including the management, ownership or operation thereof), the purchase, sale, or rescission of any Security of the Debtors or the Reorganized Debtors, the subject matter of, or the transactions or events giving rise to, any Claim or Interest that is treated in the Plan, the business or contractual arrangements between any Debtor and any Released Party, the Debtors' in- or out-of-court restructuring efforts, intercompany transactions, the ABL Credit Agreement, the Term Loan Credit Agreement, the Chapter 11 Cases, the Restructuring Support Agreement and related prepetition transactions, the Backstop Commitment Letter, the Disclosure Statement, the *658 New Corporate Governance Documents, the Exit Facilities, the Plan (including, for the avoidance of doubt, providing any legal opinion requested by any Entity regarding any transaction, contract, instrument, document, or other agreement contemplated by the Plan or the reliance by any Released Party on the Plan or the Confirmation Order in lieu of such legal opinion), the filing of the Chapter 11 Cases, the pursuit of Confirmation, the pursuit of Consummation, the administration and implementation of the Plan, including the issuance or distribution of Securities pursuant to the Plan, or the distribution of property under the Plan or any other related agreement, or upon any other act, omission, transaction, agreement, event, or other

AMERICAN BANKRUPTCY INSTITUTE

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

occurrence (in each case, related to any of the foregoing) taking place on or before the Effective Date.
(USTAPP 2461.)

The Plan defines "Releasing Party" broadly to include:

[C]ollectively, and in each case in its capacity as such: (a) each of the Debtors; (b) the Reorganized Debtors; (c) each of the Consenting Stakeholders; (d) the ABL Agent; (e) the ABL Lenders; (f) Term Loan Agent; (g) the Term Loan Lenders; (h) each of the lenders and administrative agents under the Exit Facilities; (i) the Backstop Parties; (j) the DIP ABL Agent; (k) the DIP ABL Lenders; (1) the DIP Term Agent; (m) the DIP Lenders; (n) all holders of Impaired Claims who voted to accept the Plan; (o) all holders of Impaired Claims who abstained from voting on the Plan or voted to reject the Plan but did not timely opt out of or object to the applicable release; (p) all holders of Unimpaired Claims who did not timely opt out of or object to the applicable release; (q) all holders of Interests; (r) the Plan Administrator; (s) each current and former Affiliate of each Entity in foregoing clause (a) through the following clause (t); (t) each Related Party of each Entity in the foregoing clause (a) through clause (t); and (u) the Creditors' Committee; provided that, in each case, an Entity shall not be a Releasing Party if it: (x) elects to opt of the releases contained in the Plan, or (y) timely objects to the releases contained in the Plan and such objection is not resolved before Confirmation; provided further that any such Entity shall not receive the Avoidance Action waiver. (USTAPP 2427.) Thus, Releasing Parties includes all holders of claims and interests who do not timely opt out of or object to the Third-Party Releases.

Likewise, the Plan defines "Released Party" broadly, to include:

[C]ollectively, each of the following in their capacity as such: (a) each of the Debtors; (b) the Reorganized Debtors; (c) each of the Consenting Stakeholders; (d) the ABL Agent; (e) the ABL Lenders; (f) the Term Loan Agent; (g) the Term Loan Lenders; (h) each of the lenders and administrative agents under the Exit Facilities; (i) the Backstop Parties; (j) the DIP ABL Agent; (k) the DIP ABL Lenders; (1) the DIP Term Agent; (m) the DIP Term Lenders; (n) the Plan Administrator; (o) each current and former Affiliate of Each Entity in the foregoing clause (a) through this clause (p); (p) each Related Party of each Entity in the foregoing clause (a) through this clause (p); and (q) the Creditors' Committee; provided that any holder

of a Claim or Interest that opts out of the releases shall not be a "Released Party."

(USTAPP 2427.)

In turn, the Plan then defines the term "Related Party" to include:

*659 [W]ith respect to any person or Entity, each of, and in each case in its capacity as such, current and former directors, managers, officers, investment committee members, special or other committee members, equity holders (regardless of whether such interests are held directly or indirectly), affiliated investment funds or investment vehicles, managed accounts or funds, predecessors, participants, successors, assigns, subsidiaries, Affiliates, partners, limited partners, general partners, principals, members, management companies, fund advisors or managers, employees, agents, trustees, advisory board members, financial advisors, attorneys (including any other attorneys or professionals retained by any current or former director or manager in his or her capacity as director or manager of an Entity), accountants, investment bankers, consultants, representatives, and other professionals and advisors of such person or Entity, and any such Person's or Entity's respective heirs, executors, estates, and nominees.

(USTAPP 2426.)

Finally, the Plan provides for the following Exculpation Provision:

[N]o Exculpated Party shall have or incur, and each Exculpated Party is hereby released and exculpated from any Cause of Action or any claim arising from the Petition Date through the Effective Date related to any act or omission in connection with, relating to or arising out of, the Chapter 11 Cases, the formulation, preparation, dissemination, negotiation, filing, or termination of the Restructuring Support Agreement and related prepetition transactions, the Disclosure Statement, the Plan, the Exit Facilities, the Backstop Commitment Letter, the DIP Financing Order, Cash Collateral Order, or any Restructuring Document, contract, instrument, release or other agreement or document (including providing any legal opinion requested by any Entity regarding any transaction, contract, instrument, document, or other agreement contemplated by the Plan or the reliance by any Exculpated Party on the Plan or the Confirmation Order in lieu of such legal opinion) created or entered into in connection with the Disclosure Statement or the Plan, the

filing of the Chapter 11 Cases, the pursuit of Confirmation, the pursuit of Consummation, the administration and implementation of the Plan, including the issuance of Securities pursuant to the Plan, or the distribution of property under the Plan or any other related agreement, except for claims related to any act or omissions that is determined in a Final Order to have constituted actual fraud, willful misconduct, or gross negligence, but in all respects such Entities shall be entitled to reasonably rely upon the advice of counsel with respect to their duties and responsibilities pursuant to the Plan. The Exculpated Parties have, and upon consummation of the Plan shall be deemed to have, participated in good faith and in compliance with the applicable laws with regard to the solicitation of, and distribution of, consideration pursuant to the Plan and, therefore, are not, and on account of such distributions shall not be, liable at any time for the violation of any applicable law, rule, or regulation governing the solicitation of acceptances or rejections of the Plan or such distributions made pursuant to the Plan.

(USTAPP 2461-62.)

The Plan defines "Exculpated Parties," in turn, to include:

(a) each of the Debtors; (b) each of the Reorganized Debtors; (c) each of the Consenting Stakeholders; (d) the Creditors' Committee and its members; (e) *660 the Term Loan Agent; (f) each current and former Affiliate of each Entity in clause (a) through the following clause (g); and (g) each Related Party of each Entity in clause (a) through this clause (g).

(USTAPP 2422.)

C. The Notice

Any reasonable review of the Third-Party Releases leads to a conclusion that the releases 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. Yet, the Bankruptcy Court (and now Debtors as well) only focused on one claim against Ascena and two of its former corporate officers: a putative class action alleging securities fraud brought against Ascena, former CEO David Jaffe and former CFO Robert Giammatteo. By doing so, the Bankruptcy Court ignored all of the other potential claims (both federal and state claims) released against others covered by the releases, as well as neglected to address any other potential claims against

Jaffe and Giammatteo. This tunnel vision proves fatal to any notions of proper notice (as well as consent) in this case.

With its focus on the securities fraud litigation, the Bankruptcy Court approved a disclosure statement for dissemination to creditors and shareholders after a hearing. (USTAPP 0942, 0980-82.) The Bankruptcy Court required a Notice of Non-Voting Status to be sent to both current and former shareholders of Ascena during the Putative Class Period. The Notice of Non-Voting Status informed the recipients that they could opt out of the Third-Party Releases by returning an enclosed form no later than November 15, 2020. The Notice of Non-Voting Status stated in bold and underlined text that, under Debtors' Plan, "you will be deemed to have released whatever claims you may have against many other people and entities (including company officers and directors) unless you return the enclosed 'Release Opt-Out Form'." The recipient could return a hardcopy form in the pre-addressed, pre-paid envelope or electronically through an online portal, which would effectuate the opt-out.

The Bankruptcy Court did not order that any notice or optout forms be sent to all of the Releasing Parties, including the current and former employees, consultants, accountants or attorneys of Debtors, their affiliates, lenders, creditors or interest holders. Nor did it even examine other possible causes of action released. Prime Clerk — essentially a middleman in this process — bore responsibility for notifying the equity holders. Prime Clerk sent the notice and opt-out forms by first-class mail to all current and former registered holders identified by Ascena's transfer agent, American Stock Transfer & Trust Company, LLC ("AST"). As to the beneficial holders, Prime Clerk served the notice and opt-out forms on the list of Nominees with instructions to forward the materials to their beneficial holder clients as of the voting record date and their beneficial holder clients who had purchased or otherwise acquired the equity interest during the Putative Class Period. Additionally, the Bankruptcy Court ordered publication of a general notice of the confirmation hearing in USA Today and The New York Times. (USTAPP 0985-86.) This notice ran for one day and included the day and time of the hearing, the deadline by which to object to the Plan and that the Plan contained a third-party release. (USTAPP 1559.)

Throughout this process, Debtors sent notice of the Third-Party Releases and the opt-out procedure to roughly 300,000 parties believed to be potential members of the putative class

action case pending in *661 the New Jersey district court. The record lacks any information about how many of the parties actually received the notice or any mention of efforts to determine the success of the attempts at notice regarding the securities fraud litigation. As of November 18, 2020, Debtors had received approximately 596 Release Opt-Out Forms approximately 0.2% of those targeted by the notice.

D. The Securities Litigation

Although not directly related to the procedural or factual history of the bankruptcy proceeding, the Third-Party Releases essentially thwart a lawsuit filed in a separate federal court. In June 2019, the Securities Litigation Lead Plaintiffs filed a federal securities putative class action in the United States District Court for the District of New Jersey.⁶ On November 21, 2019, the Securities Litigation Lead Plaintiffs filed a Consolidated Amended Complaint against Debtors and the Individual Defendants, which included Debtors' former CEO (Jaffe) and CFO (Giammatteo). The proposed class included all persons, other than the defendants, who purchased or otherwise acquired Debtors' common stock between December 1, 2015 and May 17, 2017. The Amended Complaint asserts claims under the Securities Exchange Act of 1934 and generally alleges that the defendants engaged in a deceptive scheme and made false and misleading statements and omissions that artificially inflated the price of the common stock during the class period.

The Securities Litigation Lead Plaintiffs objected to the Third-Party Releases, but the Bankruptcy Court overruled their objections. Moreover, they attempted to opt out of the Third-Party Releases on behalf of the putative class, but the Bankruptcy Court denied that request. The Securities Litigation Lead Plaintiffs now appeal those decisions, as the Third-Party Releases in this case has halted the New Jersey case before reaching the class certification stage.

II. PROCEDURAL HISTORY

On March 12, 2021, the Securities Litigation Lead Plaintiffs filed two notices of appeal of the Confirmation Order to this Court. In their appeals, the Securities Litigation Lead Plaintiffs argue that the Bankruptcy Court erred in approving the Third-Party Releases to the extent that the Third-Party Releases relate to the claims asserted in the Securities Litigation. (Opening Br. of Appellants Joel Patterson and Michaella Corp. ("Appellants' Br.") at 7 (ECF No. 30).) The Securities Litigation Lead Plaintiffs further argue that the Bankruptcy Court erred in finding that they lack standing to object to the Third-Party Releases and that they could not opt out on behalf of the class that they seek to represent. (Appellants' Br. at 7-8.)

On March 26, 2021, the Trustee filed a notice of appeal of the Confirmation Order to this Court.⁸ The Court consolidated the Trustee's appeal with the other pending appeals into this case and set a briefing schedule. (ECF Nos. 11, 15.) In his appeal, the Trustee argues that the Bankruptcy Court erred by approving the Third-Party Releases and Exculpation Provision contained *662 in the Plan and approved by the Confirmation Order. (Br. of Appellee [sic] John P. Fitzgerald, III, Acting United States Trustee For Region 4 ("Trustee Br.") at 2 (ECF No. 35).) The Trustee further argues that the Bankruptcy Court erred in the manner in which it conducted the confirmation approval process. (Trustee Br. at 47-50.)

After filing the appeal, the Trustee filed a motion to stay in the Bankruptcy Court, asking the Bankruptcy Court to stay the application of the Plan's exculpation and release provisions pending the adjudication of this appeal. On May 13, 2021, the Bankruptcy Court conducted a hearing on the stay motion below. Then, on May 28, 2021, the Bankruptcy Court denied the Trustee's stay motion and entered a Memorandum Opinion ("Bankr. Stay. Op." (USTAPP 2877-2904)) setting forth its findings of facts and conclusions of law.

On June 2, 2021, the Trustee filed a Motion to Stay in this Court (ECF No. 18), in which the Securities Litigation Lead Plaintiffs joined. (ECF No. 28.) Debtors opposed the stay. (ECF No. 27.) On June 28, 2021, the Court denied the Motion to Stay, finding that the Trustee had failed to meet the high burden required for a party seeking a stay. (ECF Nos. 33-34.)

On September 10, 2021, Debtors filed their Response Brief for Appellee Mahwah Bergen Retail Group, Inc. (("Appellee Br.") (ECF No. 43).) On October 11, 2021, the Securities Litigation Lead Plaintiffs and the Trustee each filed a reply brief, respectively. (("Trustee Reply Br.") (ECF No. 45); (Reply Br. of Appellants Joel Patterson and Michaela Corp.) ("Appellants' Reply Br.") (ECF No. 46).) On December 20, 2021, the Court held oral argument on this appeal, rendering it ripe for review. For the reasons stated below, the Court finds that the Bankruptcy Court erred in its approval of the Third-Party Releases and the Exculpation Provision.

III. STANDARD OF REVIEW

[8] "When reviewing a decision of the [4] [6] [7] bankruptcy court [rendered in a core proceeding], a district court functions as an appellate court and applies the standards of review in federal courts of appeal." Paramount Home Ent. Inc. v. Cir. City Stores, Inc., 445 B.R. 521, 526-27 (E.D. Va. 2010) (citing In re Webb, 954 F.2d 1102, 1103-04 (5th Cir. 1992)). Specifically, "[t]he district court reviews the bankruptcy court's legal conclusions de novo and its factual findings for clear error." Mar-Bow Value Partners, LLC v. McKinsey Recovery & Transformation Serv. US, LLC, 578 B.R. 325, 328 (E.D. Va. 2017) (citing In re Harford Sands Inc., 372 F.3d 637, 639 (4th Cir. 2004)). Clear error exists when the district court " 'is left with the definite and firm conviction that a mistake has been committed." "Id. (quoting Anderson v. Bessemer City, 470 U.S. 564, 573, 105 S.Ct. 1504, 84 L.Ed.2d 518 (1985)). In cases involving questions of law and fact, the Court reviews findings of fact under the clearly erroneous standard and reviews de novo the legal conclusions derived from those facts. Gilbane Bldg. Co. v. Fed. Rsv. Bank of Richmond, Charlotte Branch, 80 F.3d 895, 905 (4th Cir. 1996).

[9] Conversely, if the proceeding before the Bankruptcy Court constitutes a non-core proceeding and the parties did not consent to the Bankruptcy Court's jurisdiction, "the district court ... undertake[s] de novo analysis of both the factual findings to which [the appellant] objected and the law." *In re Apex Express Corp.*, 190 F.3d 624, 630 (4th Cir. 1999). Indeed, 28 U.S.C. § 157(c)(1) directs:

A bankruptcy judge may hear a proceeding that is not a core proceeding but that is otherwise related to a case under *663 title 11. In such proceeding, the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected.

Relatedly, Bankruptcy Rule 8018.1 provides that:

If, on appeal, a district court determines that the bankruptcy court did not have the power under Article III of the Constitution to enter the judgment, order, or decree appealed from, the district court may treat it as proposed findings of fact and conclusions of law.

Fed. R. Bankr. P. 8018.1. The district court then reviews such proposed findings of fact and conclusions of law *de novo*. Fed. R. Bankr. P. 9033(d).

IV. ANALYSIS

This appeal requires the Court to first determine whether the Bankruptcy Court exceeded its authority under the Constitution when it released the claims included in the Third-Party Releases. This analysis will encompass whether the Releasing Parties consented to the jurisdiction of the Bankruptcy Court. Next, the Court must determine whether the Bankruptcy Court erred in approving the Third-Party Releases under applicable Fourth Circuit standards. This, again, will require an analysis of whether the parties consented to the Third-Party Releases. Then, the Court will address Appellee's argument that the Court must dismiss this appeal on equitable mootness grounds. Finally, the Court will examine the challenge to the Exculpation Provision. However, before addressing the merits of the appeal, the Court will address whether Appellants have standing to press this appeal.

A. Standing to Appeal

1. The United States Trustee's Standing to Appeal

[11] During oral argument, Debtors' counsel conceded that Debtors have no challenge to the standing of the Trustee to appeal. (Arg. Tr. at 20:10-11.) Debtors make this concession for good reason. The Bankruptcy Code gives the United States Trustee standing, providing that the Trustee "may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to section 1121(c) of this title." 11 U.S.C. § 307. The Trustee serves the role of "protecting the public interest and ensuring that bankruptcy cases are conducted according to law." In re Clark, 927 F.2d 793, 795 (4th Cir. 1991) (quotations omitted). Given their role, the Fourth Circuit has recognized that a trustee could never satisfy the "person aggrieved standard," discussed below, but still has standing to appeal adverse bankruptcy decisions in its role as a "public watchdog" over bankruptcy proceedings. See id. at 796 ("[S]tanding to appeal under the Bankruptcy Act as a 'party aggrieved' may arise from a party's official duty to enforce the bankruptcy law in the public interest."). The Fourth Circuit noted that, "had Congress intended to prohibit U.S. trustees

from appealing adverse bankruptcy court rulings, it would have done so explicitly." *Id.* Accordingly, the Trustee has standing to appeal to this Court. And, his appeal of the Third-Party Releases encompasses the appeal advanced by the Securities Litigation Lead Plaintiffs. This leaves the Court with no reservations that it can consider the merits of the appeal regardless of whether the Securities Litigation Lead Plaintiffs have standing.

*664 2. The Securities Litigation Lead Plaintiffs' Lack of Standing to Appeal

The Debtors do, however, challenge the Securities Litigation Lead Plaintiffs' standing to prosecute this appeal. (Appellee Br. at 48.) Specifically, Debtors argue that by objecting to the Third-Party Releases, the Securities Litigation Lead Plaintiffs opted out of the release and, therefore, it has no impact on them. The Court agrees and finds that the Securities Litigation Lead Plaintiffs lack standing to prosecute this appeal.

[12] [13] "The test for standing to appeal a bankruptcy court's order to the district court is well-established: the appellant must be a *person aggrieved* by the bankruptcy order." *Mar-Bow Value Partners, LLC v. McKinsey Recovery & Transformation Serv. US LLC*, 469 F. Supp. 3d 505, 523 (E.D. Va. 2020) (internal quotations omitted). To satisfy the person aggrieved standard, "the appellant must show that the order diminishes its property, increases its burdens, or impairs its rights." *Id.* (internal quotations omitted).

Here, the Securities Litigation Lead Plaintiffs argue that they were placed in a "death trap" by being forced to choose between either not opting out, and thereby waiving significant rights, or opting out (as they ultimately chose) and risking a challenge to their standing. Although the Court is sympathetic to the conundrum in which they were placed, tough strategic decisions do not confer standing. Moreover, this tough strategic decision resulted in the Third-Party Releases having no binding effect on them as individuals. They may still pursue any and all claims that the Third-Party Releases purport to release. Thus, they cannot complain of any diminution of property, increase in burden or impairment of rights in their individual capacity. Although they claim that the Third-Party Releases inhibit their ability to enlarge their recovery in the Securities Action (Appellants' Reply at 18), they actually seek to enlarge the recovery of the putative class — i.e., more class members obtaining a recovery, leading to a greater overall class recovery - not necessarily their own personal recovery. As such, the Securities Litigation Lead Plaintiffs must pin their hopes of establishing standing on harm suffered in their capacity as putative representatives of the class.

[16] However, the Securities Litigation Lead [14] [15] Plaintiffs' capacity as putative representatives of a class in the District of New Jersey does not confer standing to appeal in this Court. The Securities Litigation Lead Plaintiffs claim that they have standing "because they are fiduciaries for the Class, have rights closely aligned with those of Class members, and are the court-appointed advocate for Class members' rights." (Appellants' Reply at 19.) However, this argument puts too much weight on their role as putative class representatives. As lead plaintiffs in a putative class action, the Securities Litigation Lead Plaintiffs have no special status; consequently, they must establish individualized harm. See Campbell-Ewald Co. v. Gomez, 577 U.S. 153, 165, 136 S.Ct. 663, 193 L.Ed.2d 571 (2016) ("While a class lacks independent status until certified,... a would-be class representative with a live claim of her own must be accorded a fair opportunity to show that certification is warranted."). As the Fourth Circuit has noted, "[n]ot every effort to represent a class will succeed; the representative is an agent only if the class is certified." Gentry v. Siegel, 668 F.3d 83, 90 (4th Cir. 2012). Accordingly, the Securities Litigation Lead Plaintiffs' argument that their representative capacity confers standing on them relies on the speculation that they will eventually represent a certified class. But, "[s]peculation and conjecture *665 do not give rise to bankruptcy appellate standing." Mar-Bow, 469 F. Supp. 3d at 532.

[17] Two appellate decisions support this conclusion. In *Gentry*, the Fourth Circuit concluded that the named plaintiffs in putative classes lacked standing to challenge the notice procedures employed by the bankruptcy court. 668 F.3d at 95. The plaintiffs had received the actual notice, such that they could not challenge the notice on behalf of themselves, and the Fourth Circuit concluded that they did "not have standing to assert the due process rights of others who are not parties." *Id.* Similarly, here, the Securities Plaintiffs cannot challenge on their own behalf the Third-Party Releases that no longer (due to the opt out) release their own individual claims, and they lack standing to challenge the Third-Party Releases on behalf of others who are not parties.

Likewise, the Second Circuit encountered a nearly identical circumstance to the facts here in *In re Dynegy, Inc.*, 770 F.3d 1064 (2d Cir. 2014). There, a named plaintiff in a

putative securities class action sought to challenge the thirdparty releases in a confirmation plan that would release nondebtor officers. *Id.* at 1067. The Second Circuit agreed with the district court that the named plaintiff lacked standing to personally challenge the plan, because he had opted out of the release. *Id.* Likewise, the Second Circuit found that he lacked standing to opt out of or object to the releases on behalf of the putative class, because the class had not been certified in either the trial court or the bankruptcy court. *Id.* at 1068-70. The same facts exist here, and the Court reaches the same conclusion.

Accordingly, the Court finds that the Securities Litigation Lead Plaintiffs lack standing to prosecute this appeal. Again, however, the Court stresses that the Trustee has standing to raise the same challenges to the Third-Party Releases as the Securities Litigation Lead Plaintiffs have raised.

B. The Constitutional Implications of the Third-Party Releases

In assessing whether the Bankruptcy Court erred in approving the Third-Party Releases, the Court will begin with a discussion of the jurisdiction of bankruptcy courts generally and whether they have the constitutional power to approve such releases. The Court will then examine whether the Releasing Parties consented to adjudication of their claims by an Article I court. The Court answers both questions in the negative.

1. The Limitations of the Jurisdiction of the Bankruptcy Courts

[18] [19] Federal district courts exercise "original and exclusive jurisdiction of all cases" under the Bankruptcy Code. 28 U.S.C. § 1334(a). District courts may refer all bankruptcy matters to bankruptcy judges, which this District has done as a matter of course since 1984. 28 U.S.C. § 157(a); see In the Matter of: The Administration of the Bankruptcy Courts and Reference of Bankruptcy Cases and Proceedings to the Bankruptcy Judges of this District (E.D. Va. Aug. 15, 1984) (Standing Order referring all bankruptcy matters to *666 Bankruptcy Court). District courts retain the authority to withdraw, in whole or in part, any case or proceeding that they had referred. See Houck v. Substitute Tr. Servs., Inc., 791 F.3d 473, 481 (4th Cir. 2015) (citing 28 U.S.C. § 157(d)). "In short, while the district courts were given jurisdiction over bankruptcy cases, Congress also delegated

to the bankruptcy courts, 'as judicial officers of the district courts,' ... adjudicatory authority, subject to the district courts' supervision as particularized in § 157 and the limits imposed by the Constitution." *Id.* (quoting *Wellness Int'l Network, Ltd. v. Sharif,* 575 U.S. 665, 679, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015)). This case implicates those limits imposed by Article III of the Constitution.

[21] Article III provides that "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." Congress has established 94 District Courts and 13 Courts of Appeals, "composed of judges who enjoy the protections of Article III: life tenure and pay that cannot be diminished." Wellness Int'l, 575 U.S. at 668, 135 S.Ct. 1932. The Supreme Court has long recognized that "Congress may not withdraw from" the Article III courts "any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty." Stern, 564 U.S. at 484, 131 S.Ct. 2594. This limitation finds its basis in the protections of life tenure and against salary diminution that Article III provides, which "help to ensure the integrity and independence of the Judiciary." Wellness Int'l, 575 U.S. at 668, 135 S.Ct. 1932. In authorizing the appointment of bankruptcy judges (who do not enjoy the Article III protections), Congress has attempted to align the responsibilities of bankruptcy judges with the boundaries set by the Constitution. However, as discussed below, the Supreme Court has found that Congress violated Article III in authorizing bankruptcy judges to decide certain claims for which litigants enjoy an entitlement to an Article III adjudication.

2. Northern Pipeline and Congress' Reaction

In Northern Pipeline Const. Co. v. Marathon Pipe Line Co., the Supreme Court considered the constitutionality of the Bankruptcy Reform Act enacted by Congress in 1978, and specifically whether the bankruptcy court had the judicial authority to adjudicate a state-law contract claim filed by the debtor against a third party. 458 U.S. 50, 54, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982). The Bankruptcy Reform Act gave the newly created bankruptcy courts power "much broader than that exercised under the former" system and enabled bankruptcy courts to decide "all civil proceedings arising under title 11 or arising in or related to cases under title 11." Id. at 55, 102 S.Ct. 2858. Thus, Congress vested the bankruptcy judges with most of the "powers of a court of equity, law,

and admiralty" without affording them the protections of Article III. Id. Because the Bankruptcy Reform Act vested "the essential attributes of the judicial power" in a non-Article III adjunct, the Supreme Court held that "[s]uch a grant of jurisdiction cannot be sustained as an exercise of Congress' power to create adjuncts to Art. III courts." Id. at 87, 102 S.Ct. 2858. Thus, it found the "broad grant of jurisdiction to the bankruptcy courts" unconstitutional and concluded that the bankruptcy court lacked jurisdiction to adjudicate the statelaw contract claim against an entity not otherwise part of the bankruptcy proceedings. Id. at 69-72, 87, 102 S.Ct. 2858.

[22] [23] Pipeline, Congress passed the Bankruptcy Amendments and Federal *667 Judgeship Act of 1984 (the "1984 Act"), revising the statutes governing bankruptcy judges and their jurisdiction. Pub. L. No. 98-353, 98 Stat. 333. Under the 1984 Act, "[t]he manner in which a bankruptcy judge may act ... depends on the type of proceeding involved." Stern, 564 U.S. at 473, 131 S.Ct. 2594. "Congress has divided bankruptcy proceedings into three categories: (1) those that arise under title 11, (2) those that arise in a title 11 case, and (3) those that are related to a case under title 11." Chesapeake Tr. v. Chesapeake Bay Enters., Inc., 2014 WL 202028, at *2 (E.D. Va. Jan. 17, 2014) (citing Stern, 564 U.S. at 473, 131 S.Ct. 2594). The first two categories constitute "core proceedings" such that a bankruptcy judge has the statutory authority to "hear and enter final judgments." Stern, 564 U.S. at 474, 131 S.Ct. 2594. With respect to the third category, non-core proceedings, a bankruptcy judge may hear a "proceeding that is not a core proceeding but that is otherwise related to a case under title 11," but, unless the parties consent, the bankruptcy judge cannot enter final judgments and instead must submit "proposed findings of fact and conclusions of law to the district court." 28 U.S.C. § 157(c)(1).

Section 157 sets forth a non-exhaustive list of examples of core proceedings. The list includes, for example, "the allowance or disallowance of claims against the estate," and "counterclaims by the estate against persons filing claims against the estate." 28 U.S.C. § 157(b)(2)(B)-(C). A party may appeal the final judgment of a bankruptcy court to the district court, which reviews it under traditional appellate standards. 28 U.S.C. § 158(a); Fed. R. Bankr. Proc. 8013. However, when a bankruptcy judge determines that a "proceeding ... is not a core proceeding but ... is otherwise related to a case under title 11," the bankruptcy judge may only "submit proposed findings of fact and conclusions of law to the district court," which then reviews de novo any matter to which a party objects. 28 U.S.C. § 157(c)(1).

3. Stern v. Marshall

The Supreme Court took up the constitutionality of the 1984 Act in Stern v. Marshall. 564 U.S. at 471, 131 S.Ct. 2594. There, the Court faced the issue of whether the bankruptcy court had jurisdiction to enter a final judgment on a counterclaim brought by the debtor against an individual who had filed a proof of claim in the bankruptcy action. [24] Following the decision in Northern Id. The Court noted that the debtor's counterclaim plainly constituted a "core" proceeding under the statute, thus giving the bankruptcy judge the statutory authority to enter a final judgment on the claim. Id. at 475, 131 S.Ct. 2594. However, the Court concluded that Article III of the Constitution did not permit the bankruptcy court to enter final judgment on the counterclaim. Id. at 482, 131 S.Ct. 2594. The counterclaim "[was] a state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor's proof of claim in bankruptcy." Id. at 487, 131 S.Ct. 2594. The Supreme Court reaffirmed that "Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case" Id. at 499, 131 S.Ct. 2594. Instead, "the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Id.* The Court found that the bankruptcy court had gone beyond constitutional limits when it "exercised the 'judicial Power of the United States' in purporting to resolve and enter final judgment on a state common law claim." Stern, 564 U.S. at 487, 131 S.Ct. 2594. Accordingly, the bankruptcy court lacked the constitutional authority to adjudicate the claim. Id. at 503, 131 S.Ct. 2594.

> *668 [25] In sum, the Supreme Court mandates that bankruptcy courts only have the constitutional authority to adjudicate core claims, even if Congress has granted them the statutory authority to resolve other claims. Naturally, this constitutional limitation applies to a bankruptcy court's authority to grant releases. See In re Millennium Lab Holdings II, LLC, 945 F.3d at 137 (holding that an approval of releases by a bankruptcy court is only "permissible if it involves a matter integral to the restructuring of the debtor-creditor relationship"); In re Purdue Pharma, L.P., 2021 WL 5979108, at *40 ("Nothing in Stern or any other case suggests that a party otherwise entitled to have a matter adjudicated by an Article III court forfeits that constitutional right if the

matter is disposed of as part of a plan of reorganization in bankruptcy. Were it otherwise, then parties could manufacture a bankruptcy court's *Stern* authority simply by inserting the resolution of some otherwise non-core matter into a plan.").

Here, by granting the Third-Party Releases, the Bankruptcy Court took jurisdiction over and extinguished the liability of an extraordinarily vast range of claims held by an immeasurable number of individuals against a broad range of potential defendants. However, before doing so, the Bankruptcy Court took no steps to determine if it had the power to extinguish the liability on any particular claim. Indeed, the only extinguished claims that the Bankruptcy Court considered were the securities fraud claims against the Individual Defendants (Jaffe and Giammatteo), and it ignored all of the other potential claims that it terminated by approving the releases. In so doing, the Bankruptcy Court failed to take the proper steps to ensure that it had the authority to grant the releases.

4. Classification of Core v. Non-Core

[26] [27] [28] [29] [30] A bankruptcy court the responsibility to properly classify the claims before it based on the content of the claims and adjudicate them according to those classifications. "It is the bankruptcy court's responsibility to determine whether each claim before it is core or non-core." Exec. Benefits Ins. Agency v. Arkison, 573 U.S. 25, 33, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014). "A cause of action is constitutionally core when it 'stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.' " Allied Title Lending, LLC v. Taylor, 420 F. Supp. 3d 436, 448 (E.D. Va. 2019) (quoting Stern, 564 U.S. at 499, 131 S.Ct. 2594). A bankruptcy estate's claim against a creditor "would necessarily be resolved in the claims allowance process when it shares common questions of fact and law with the creditor's claims and when it seeks to directly reduce or recoup the amount claimed." *Id.* (internal quotations omitted). A claim can become core when it "become[s] integral to the restructuring of the debtorcreditor relationship." Stern, 564 U.S. at 497, 131 S.Ct. 2594. Conversely, claims by the bankruptcy estate that seek to "augment the estate" but do not "directly modify the amount claimed" do not qualify as a core claim "to be resolved in ruling on the proof of claim." Allied Title Lending, LLC, 420 F. Supp. 3d at 448.

[31] When confronted with a so-called *Stern* claim — "a claim designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter," — the bankruptcy court should proceed with the claim as it would for non-core claims. Exec. Benefits Ins. Agency, 573 U.S. at 35-36, 134 S.Ct. 2165. That requires the bankruptcy court to "determine whether the claim may be adjudicated as a non-core claim — specifically. *669 whether it is 'not a core proceeding' but is 'otherwise related to a case under title 11." Id. at 36, 134 S.Ct. 2165. If it satisfies the "otherwise related to a case under title 11" as required by 28 U.S.C. § 157(c)(1), then the bankruptcy court "should hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment." Id. at 36, 134 S.Ct. 2165. Of course, if the claim has no relation to a case under title 11, then the bankruptcy court lacks any authority to act on it.

[32] Stern teaches that courts should focus on the content of the proceeding rather than the category of the proceeding when determining whether a bankruptcy court has acted within its constitutional authority. The Stern Court explained that counterclaims that do not "stem[] from the bankruptcy hatself or would [not] necessarily be resolved in the claims allowance process" must be decided by Article III courts. Stern, 564 U.S. at 497, 131 S.Ct. 2594. The Court never declared that all counterclaims by a debtor fall outside of a bankruptcy court's jurisdiction. Instead, the Court looked to the content of the debtor's counterclaim and compared the factual and legal determinations necessary to resolve the counterclaim to those necessary to resolve the original claim. Id. at 498-99, 131 S.Ct. 2594. It did so to assess whether the counterclaim would necessarily be resolved in the claimsallowance process. *Id.* In doing so, the Court focused on the basis for the counterclaim to determine whether it stemmed from the bankruptcy itself. Id. Given Stern's focus on the content of the claim over its categorization, courts cannot bypass the constitutional limitations simply by categorizing a widely varying swath of claims as "core" and then assuming jurisdiction over them.

a. The Bankruptcy Court Failed to Identify Whether it had Jurisdiction Over the Claims That it Released.

[33] Here, the Bankruptcy Court engaged in none of the content-based analysis demanded by *Stern*. The Bankruptcy Court did not parse the content of the claims that it purported to release to determine if each claim constituted a core claim,

a non-core claim or a claim unrelated to the bankruptcy case. The sheer breadth of the Third-Party Releases renders this a herculean undertaking and underscores the constitutional questionability of the Bankruptcy Court's actions. However, the enormity of the task does not absolve the Bankruptcy Court of its responsibility to properly identify the content of the claims before it and ensure that it has jurisdiction to rule on each of them. In fact, because of the constitutional implications of extinguishing these claims, this undertaking carries even greater import. As an appellate court, this Court will not speculate as to the claims released and then parse each purportedly released claim to determine whether the Bankruptcy Court had the power to extinguish that claim — that was the responsibility of the Bankruptcy Court. In re Continental Airlines, 203 F.3d 203, 214 (3d Cir. 2000) ("The hallmarks of permissible non-consensual releases fairness, necessity to the reorganization, and specific factual findings to support these conclusions — are all absent here."). The sheer breadth of the releases and the lack of findings with respect to each released claim renders appellate review virtually impossible and speaks to the impropriety of the approval of the Third-Party Releases.

b. The Bankruptcy Court Lacks Jurisdiction Over Many Released Claims.

[35] Although the Court cannot determine precisely [34] which Released Claims *670 the Bankruptcy Court could have adjudicated, it takes only a cursory review of the Third-Party Releases and the Releasing Parties to find released claims that the Bankruptcy Court lacked the authority to adjudicate. The universe of released claims includes claims between non-debtors which may have no connection to the property of Mahwah's bankruptcy estate or the administration of the Bankruptcy Proceeding. For example, the Third-Party Release would bar securities claims, such as those brought by the Securities Plaintiffs, against former directors and officers of Mahwah, even if the claims arose before Mahwah filed for bankruptcy and those directors and officers had no involvement in the Bankruptcy Proceeding. And it bears noting that "federal courts disfavor indemnity for federal securities law violations, calling into question the enforceability of these obligations." In re Continental Airlines, 203 F.3d at 216 (citing cases). Thus, the only type of released claim that the Bankruptcy Court actually considered finds antipathy in the case law.

The Trustee points out numerous other potential claims that the Bankruptcy Court released. (Trustee Br. at 33.) These include hostile work environment claims by a former Mahwah employee against another Mahwah employee; negligence by a Mahwah employee against a consultant hired by Mahwah to counsel employees on retirement plans; slander by a former employee of Mahwah's term lenders against a current employee of the lender for remarks that the former employee mishandled the lender's deal with Mahwah; a breach of contract action by an accountant of one of Mahwah's loan agents against the agent for failure to pay for the work that the account performed on the agent's transaction with Mahwah; and malpractice by an affiliate of Mahwah against its law firm for the firm's simultaneous representation of both the affiliate and Mahwah when their interests diverged. (Trustee Br. at 33.) None of these claims appear even related — much less integral to the restructuring of the debtor-creditor relationship, such that the Bankruptcy Court could adjudicate them without running afoul of the Constitution. And, given the breadth of the releases, the above examples likely represent only a fraction of the purportedly released claims that lack an integral connection to the bankruptcy process, such that the Bankruptcy Court lacked the power to release them.

5. The Implication of *Stern's* Constitutional Analysis on the Released Claims

Debtors' argument that the Third-Party Releases do not implicate *Stern's* constitutional limitations fails. Essentially, Debtors ask the Court not to parse the released claims in any way and, instead, find that the Bankruptcy Court had constitutional authority based on the inclusion of the Releases in the Plan. (Appellee Br. at 57-59.) This argument would require the Court to conclude that only the Plan Confirmation Order constitutes a judgment and that jurisdiction over confirmation proceedings cures any jurisdictional defects within those proceedings. The Court concludes neither.

a. The Bankruptcy Court Must Have Jurisdiction Over a Claim to Release it.

[36] First, the releases here implicate the constitutional limits on the Bankruptcy Court's ability to adjudicate claims, even if they do not constitute a judgment following a hearing on the merits of the claim. Once the Plan became final, the provisions therein, including the Third-Party Releases,

became res judicata for subsequent parties trying to bring the claims. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 152, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009); *671 In re Purdue Pharma, L.P., 2021 WL 5979108, at *41 ("Nor is there any doubt that the entry of an order releasing a claim has former adjudication effects, which is a key attribute of a final judgment. The Supreme Court has twice held that non-consensual third-party releases confirmed by final order are entitled to res judicata claim preclusion barring any subsequent action bringing a released claim"). Likewise, when the Bankruptcy Court declared the releases consensual settlements of the claims, they became final judgments on the merits for purposes of further litigation. See Larken, Inc. v. Wray, 189 F.3d 729, 732 (8th Cir. 1999) (stating that a voluntary dismissal with prejudice "constitutes a final judgment on the merits"); Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1050 (5th Cir. 1987) (holding that order confirming plan that released creditor's claims against guarantor was a final judgment on the merits of those claims); see also In re Digital Impact, Inc., 223 B.R. 1, 12, 13 n.6 (Bankr. N.D. Okla. 1998) ("A release, or permanent injunction, contained in a confirmed plan ... has the effect of a judgment — a judgment against the claimant and in favor of the non-debtor, accomplished without due process.").

At bottom, the Bankruptcy Court extinguished the Released Claims, which amounts to adjudication of the claim for *Stern* purposes. *In re Purdue Pharma, L.P.*, 2021 WL 5979108, at *41 ("There really can be no dispute that the release of a claim 'finally determines' that claim. It does so by extinguishing the claim, so that it cannot be adjudicated on the merits. A nonconsensual third-party release is essentially a final judgment against the claimant, in favor of the non-debtor, entered 'without any hearing on the merits.'"). To claim that the Bankruptcy Court can fully extinguish these claims based solely on their inclusion in the Plan — without any hearing on them or any findings about them —amounts to arguing that courts need not have the authority to extinguish claims so long as they provide no procedural safeguards in extinguishing the claims. Obviously, this cannot be.

Likewise, the argument that the Bankruptcy Court possesses the power to extinguish these claims based only on its jurisdiction over confirmation proceedings misses the mark. True, bankruptcy courts have jurisdiction over Chapter 11 proceedings under 28 U.S.C. § 157(a), and plan confirmation proceedings constitute core proceedings that the bankruptcy court may adjudicate on a final basis. 28 U.S.C. § 157(b)(2) (L). Further, 11 U.S.C. § 105(a) permits the bankruptcy court

to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." But, this grant of authority has limits.

[37] [38] Although § 105 permits a bankruptcy court to issue orders necessary or appropriate to carry out the provisions of the Bankruptcy Code, that section does not provide an independent source of federal subject matter jurisdiction. *In re Combustion Engineering, Inc.*, 391 F.3d 190, 224-25 (3d Cir. 2004) ("But as the statute makes clear, § 105 does not provide an independent source of federal subject matter jurisdiction."). Thus, independent statutory basis must exist for the bankruptcy court to exercise jurisdiction over the claims. *See In re Johns-Manville Corp.*, 801 F.2d 60, 63 (2d Cir. 1986) ("Section 105(a) does not, however, broaden the bankruptcy court's jurisdiction, which must be established separately").

[39] [40] [42] Without an independent source [41] of jurisdiction, a bankruptcy court must rely on its own jurisdiction, which comes in the form of in rem jurisdiction over the debtor's property and the disposition of that property. See *672 Cent. Virginia Cmty. Coll. v. Katz, 546 U.S. 356, 362, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006) ("Bankruptcy jurisdiction, at its core, is in rem."). It is certainly true "that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships." United States v. Energy Res. Co., Inc., 495 U.S. 545, 549, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990). Yet, third-party claims belong to third parties, not the debtor's estate. "As a general rule, a bankruptcy court has no power to say what happens to property that belongs to a third party, even if that third party is a creditor or otherwise is a party in interest." In re Aegean Marine Petroleum Network, Inc., 599 B.R. 717, 723 (Bankr. S.D.N.Y. 2019) (citing Callaway v. Benton, 336 U.S. 132, 136-41, 69 S.Ct. 435, 93 L.Ed. 553 (1949)).

[43] Similarly, although a bankruptcy court's *in rem* jurisdiction gives it authority over claims against the estate, it has no *in rem* jurisdiction over third-party claims not against the estate or property of the estate. *See In re Johns-Manville Corp.*, 600 F.3d at 153-54 (holding that a bankruptcy court did not have *in rem* jurisdiction over a third party's direct claims against a non-debtor insurer). Additionally, bankruptcy courts have subject matter jurisdiction over "civil proceedings" that are "related to" a bankruptcy case. 28 U.S.C. §§ 157, 1334. However, the Third-Party Releases here purport to release claims that may not yet constitute any pending civil proceeding.

Additionally, many of the claims lack any relation to the bankruptcy case, even affording "related to" jurisdiction the most liberal reading. Debtors' argument that bankruptcy courts must be able to confirm plans even if those plans affect other cases has it backwards. (Appellee's Br. at 59.) The Plan confirmation does not merely have a "tangential effect" on the Securities Litigation and other claims. Rather, the Plan has the ultimate effect — extinguishment — on the claims despite having — at most — a tangential effect on the bankruptcy estate. Therefore, the bankruptcy court has no independent authority on which to rely.

[44] Indeed, as discussed above, Stern and its progeny stand for the proposition that Congress cannot enlarge the subject matter jurisdiction of the bankruptcy courts beyond permissible constitutional limits. Thus, Congress could not eviscerate the limits of Article III jurisdiction by enacting § 105. Article III simply does not allow third-party non-debtors to bootstrap any and all of their disputes into a bankruptcy case to obtain relief. See In re Midway Gold US, Inc., 575 B.R. 475, 519 (Bankr. D. Colo. 2017) ("If proceedings over which the Court has no independent jurisdiction could be metamorphisized into proceedings within the Court's jurisdiction by simply by including their release in a proposed plan, this [Bankruptcy] Court could acquire infinite jurisdiction.") (citations omitted). Moreover, the Court does not view releasing a claim held by a third-party non-debtor against another third-party non-debtor as an "appropriate" order to carry out the Bankruptcy Code. And certainly, given many of the released claims' complete attenuation to the bankruptcy estate and proceeding, these releases cannot be considered "necessary." Any finding by the Bankruptcy Court otherwise constitutes a clear error.

b. The Parties did not Consent to Article I Adjudication of Non-Core Claims.

The Debtors further argue that the Third-Party Releases do not implicate the jurisdictional constraints of *Stern*, because the parties consented to the Releases. (Appellee Br. at 55-56.) This argument ignores the standard that the Supreme Court has *673 set for consenting to bankruptcy court jurisdiction. Likewise, the Bankruptcy Court ignored the standard that must be met to find that a party has consented to its jurisdiction. As discussed below, the record contains no evidence that could meet the Supreme Court's standard for consent to non-Article III jurisdiction.

i. The Supreme Court's Standard for Consent

Following *Stern*, the Supreme Court took up the issue of whether a party could consent to having the bankruptcy court decide a *Stern* claim in *Wellness International Network, Ltd. v. Sharif*, 575 U.S. 665, 135 S.Ct. 1932, 191 L.Ed.2d 911 (2015). The Court first answered the question of whether a litigant could waive the right to an Article III court, concluding that "allowing bankruptcy litigants to waive the right to Article III adjudication of *Stern* claims does not usurp the constitutional prerogatives of Article III courts." *Id.* at 679, 135 S.Ct. 1932. In reaching this decision, the Court relied on the fact that "*Stern* — like its predecessor, *Northern Pipeline* — turned on the fact that the litigant did not truly consent to resolution of the claim against it in a non-Article III forum." *Id.* at 681, 135 S.Ct. 1932 (quotations omitted).

However, the Court next determined what constituted valid consent to adjudication by a bankruptcy court. The Court rejected the argument that "such consent must be express." *Id.* at 683, 135 S.Ct. 1932. Instead, it held that "[t]he implied consent standard articulated in *Roell* supplies the appropriate rule for adjudications by bankruptcy courts under § 157." *Id.* at 684, 135 S.Ct. 1932. Therefore, "the key inquiry is whether the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case before the non-Article III adjudicator." *Id.* at 685, 135 S.Ct. 1932 (cleaned up). An understanding of the standard in *Wellness* necessitates a brief review of *Roell v. Withrow*, 538 U.S. 580, 123 S.Ct. 1696, 155 L.Ed.2d 775 (2003).

In Roell, the Supreme Court held that consent to proceedings before a magistrate judge under 28 U.S.C. § 636(c) need not be express and instead can be inferred from a party's conduct during litigation. 538 U.S. at 582, 123 S.Ct. 1696. In *Roell*, the plaintiff agreed orally and in writing to having the magistrate judge preside over the entire case. Id. at 582-83, 123 S.Ct. 1696. The district judge then referred the case to the magistrate judge for final disposition, but with the caveat that the defendants would have the opportunity to consent and the referral order would be vacated if they did not consent. Id. at 583, 123 S.Ct. 1696. The clerk then sent the referral order to the defendants with instructions to submit a separate pleading indicating whether they consented or not. Id. One defendant consented to magistrate judge jurisdiction, but two others did not take a position at all. Id. The magistrate judge then proceeded to preside over a jury trial all the way to a verdict

and judgment. *Id.* On at least three different instances, the parties did nothing when the magistrate judge stated that the parties had consented to her jurisdiction. *Id.* at 584, n.1, 123 S.Ct. 1696. Following the judgment, the defendants submitted their consent in writing, but the district court and the Fifth Circuit Court of Appeals nevertheless vacated the judgment, ruling that consent had to be express under § 636(c). *Id.* at 585, 123 S.Ct. 1696.

The Supreme Court disagreed that consent to magistrate judge jurisdiction had to be expressly written. Id. at 586, 123 S.Ct. 1696. Instead, it found that the parties had "clearly implied their consent by their decision to appear before the Magistrate *674 Judge, without expressing any reservation, after being notified of their right to refuse and after being told that she intended to exercise case-dispositive authority." *Id.* The Court noted that allowing the conduct of the parties to determine consent "checks the risk of gamesmanship by depriving parties of the luxury of waiting for the outcome before denying the magistrate judge's authority." Id. at 590, 123 S.Ct. 1696. Accordingly, it concluded that "the better rule is to accept implied consent where, as here, the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case before the Magistrate Judge." Id.

In *Wellness*, the Supreme Court found that applying the same standard in the bankruptcy context possessed the same pragmatic virtues that motivated its adoption in the magistrate judge concept. 575 U.S. at 684-85, 135 S.Ct. 1932. However, the Court made clear that this standard has teeth: "[i]t bears emphasizing, however, that a litigant's consent — whether express or implied — must still be knowing and voluntary." *Id.* at 685, 135 S.Ct. 1932 (citing *Roell*, 538 U.S. at 587, n.5, 123 S.Ct. 1696 ("notification of the right to refuse" adjudication by a non-Article III court "is a prerequisite to any inference of consent")).

ii. The Bankruptcy Court Incorrect Application of the Standard for Consent

[45] Applying this standard here, it becomes clear that the Bankruptcy Court erred as a matter of law in finding that failure to return the opt-out form could constitute consent to Article I adjudication. The Bankruptcy Court relied on the fact that the Releasing Parties received notice and an opportunity to opt out of the Third-Party Releases as the basis for consent. (Bankr. Confirm. Op. at 31-33.) But, the

Bankruptcy Court made this determination in the context of whether the Releasing Parties consented to the Third-Party Releases, not the threshold question of whether they consented to having the Bankruptcy Court adjudicate the released claims. ¹⁰ This will not suffice to support a finding of consent to Article I adjudication for all of the Releasing Parties.

[46] Wellness and Roell make clear that courts can discern the implication of consent to a non-Article III court based on a party's actions. However, they do not permit a finding of consent based on inaction. In finding consent to Article I adjudication, *Roell* relied on the litigation conduct of the parties and the fact that they appeared before the magistrate judge to try their case after notification of the referral. Indeed, the Court even cited the definition of an appearance as an "overt act by which a party submits himself to the court's jurisdiction." Roell, 538 U.S. at 586, n.3, 123 S.Ct. 1696. This reliance on the overt act of appearing in the non-Article III court demonstrates the importance of actions over inactions. Likewise, Wellness cited to Roell for the proposition that "actions rather than words" can support a finding of consent and that "the key inquiry is whether the litigant or counsel was made aware of the need for consent and the right to refuse it, and still voluntarily appeared to try the case before the non-Article III adjudicator." Wellness Int'l, 575 U.S. at 684-85, 135 S.Ct. 1932 (cleaned up). Importantly, any consent *675 "must still be knowing and voluntary." *Id.* at 685, 135 S.Ct. 1932.

[47] Here, the Court cannot discern any actions undertaken by the Releasing Parties to support a finding that they knowingly and voluntarily consented to Article I adjudication of the claims that they released. Despite the enormous breadth of Releasing Parties deemed to have released claims, the Bankruptcy Court undertook no analysis to determine which Releasing Parties (if any) had consented to bankruptcy jurisdiction and which had not. Instead, as previously noted, the Bankruptcy Court took a myopic approach to the Releasing Parties, focusing only on the putative securities fraud class action members, ignoring all other Releasing Parties. And, because the Bankruptcy Court failed to parse the core claims from non-core claims in the Third-Party Releases, the Bankruptcy Court took no steps to determine which Releasing Parties needed to consent to Article I adjudication of their claims before the Bankruptcy Court could act on them. Rather, the Bankruptcy Court merely relied on the fact that a document was mailed out with the goal of reaching thousands of individuals. Then, without regard to whether

those individuals received the document, and without regard as to whether those individuals took any overt actions in response to the document, the Bankruptcy Court determined that they had surrendered their constitutional right to an Article III court.

Again, the Bankruptcy Court ignored a wide swath of those releasing claims and, even for those targeted with the notice, the notice contained no information about agreeing to Article I adjudication. Indeed, counsel for Debtors conceded during oral argument that the distributed releases made no mention of agreeing to adjudication of their claims by an Article I court. (Arg. Tr. at 41:10-11.) In any event, the record is silent as to how many of the targeted shareholders actually received the notice. Yet, hoping (without proving) that someone received a deficient document — without any further action from that person — does not meet the standard for knowing and voluntary consent to adjudication of a non-core claim by a bankruptcy court, as set forth by the Supreme Court in *Wellness*.

Additionally, the Supreme Court in both Wellness and Roell indicated that the implied consent standard that it set forth had its basis in the elimination of gamesmanship. See, e.g., Wellness Int'l, 575 U.S. at 685, 135 S.Ct. 1932 (noting that "checking gamesmanship" motivated the adoption of the consent standard). Yet, allowing inaction to imply consent encourages the very gamesmanship that the Supreme Court intended to check. That is, non-debtors could tuck releases unrelated to a bankruptcy proceeding into bankruptcy plans, then secrete an opt-out opportunity into a convoluted legal document, send the document to non-parties previously unaware of the bankruptcy proceeding and use their nonresponse to extinguish all of their claims. This type of gamesmanship, aimed at extinguishing claims of unwitting individuals and providing a golden parachute to the parties drafting the plan, cannot be tolerated.

In words that apply equally well here, Judge McMahon wrote the following in *In re Purdue Pharma, L.P.*:

The third-party claims at issue neither stem from [the debtor's] bankruptcy nor can they be resolved in the claims allowance process. Yet those claims are being finally disposed of pursuant to the Plan; they are being released and extinguished, without the claimants' consent and without any payment, and the claimants are being enjoined from prosecuting them. Debtors and their affiliated *676 non-debtor parties cannot manufacture constitutional authority to resolve a non-core claim by the

artifice of including a release of that claim in a plan of reorganization.

2021 WL 5979108, at *41. The Bankruptcy Court here exceeded its constitutional authority without any inquiry or factfinding. Accordingly, the Bankruptcy Court erred in adjudicating the *Stern* claims without the knowing and voluntary consent of the Releasing Parties.

6. Consequence of a Stern Violation

[48] [49] Having determined that the Bankruptcy Court violated *Stern* by exceeding its authority, the Court must vacate the Confirmation Order and treat it as a Report and Recommendation with proposed findings of fact and conclusions of law, which the Court reviews *de novo. Purdue Pharma, L.P.*, 2021 WL 5979108, at *42; 28 U.S.C. § 157(c)(1); Bankruptcy Rule 8018.1. Here, unfortunately, the Bankruptcy Court's opinion lacks any meaningful factfinding, so the Court will need to set forth its own factual findings based on the record from the confirmation hearing. Bankruptcy Rule 9033(d).

[50] Before turning to the factual findings in this case, the Court pauses for an observation about the procedure for the handling of third-party releases by bankruptcy courts going forward. Due to the substantial constitutional issues at play with the use of this perilous tool, it seems preferable for a bankruptcy court to submit any third-party releases to the district court for approval via a Report and Recommendation in the rare and exceptional case that warrants the use of third-party releases. The Report and Recommendation should identify with specificity the claims and individuals released and provide detailed proposed findings of fact and conclusions of law to ensure that the released claims are truly integral to the reorganization. See In re Seaside Engineering & Surveying, Inc., 780 F.3d at 1079 (noting that this "inquiry is fact intensive in the extreme"); In re Dow Corning Corp., 280 F.3d at 657-58 (criticizing conclusory statements and mandating specific evidentiary findings with separate analysis for each individual release). This practice would necessarily avoid any Stern issues.

[51] Moreover, it would serve as an extra safeguard to ensure that third-party releases are reserved for the truly appropriate case, mindful that the use of third-party releases should be utilized "cautiously and infrequently." *Behrmann*, 663 F.3d at 712. As one bankruptcy court has observed:

[52] [53] [t]hird-party 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. Nonconsensual releases are not supposed to be granted unless barring a particular claim is important in order to accomplish a particular feature of the restructuring.

In re Aegean Marine Petroleum Network, Inc., 599 B.R. at 726-27.

C. Factual Findings Under Bankruptcy Rule 9032

The Court will now set forth its findings of facts in accordance with Rule 9033(d). The findings are based on the evidence submitted during the confirmation hearing. ¹¹ For the hearing, Debtors tendered *677 declarations from Carrie W. Teffner (President and Executive Chair of Debtors), Gary W. Begeman (a disinterested director of the Board of Directors for Debtors), Alex Orchowski (Director of Global Corporate Acts at Prime Clerk LLC), and William Kosturos (Managing Director of Alvarez & Marsal North America, LLC, who served as Debtors' financial advisor). Teffner and Begeman also testified during the confirmation hearing on February 25, 2021.

The Court finds the following facts as relevant to the issues presented in this appeal:

1. On June 7, 2019, Securities Litigation Lead Plaintiffs filed a complaint as a putative class action in the District of New Jersey alleging securities fraud against Ascena Retail Group, Inc., David Jaffe and Robert Giammatteo in Newman v. Ascena Retail Group, Inc., et al, Case No. 2:19cv13529 (D.N.J.). On August 23, 2019, United States District Judge Kevin McNulty appointed Securities Litigation Lead Plaintiffs and their counsel as lead plaintiff and lead counsel, respectively. (Dkt. No. 26, Newman v. Ascena Retail Group, Inc., et al, Case No. 2:19cv13529 (D.N.J.) ("D.N.J. Dkt.").) On February 7, 2020, the defendants in that case filed a motion to dismiss that remains pending. (D.N.J. Dkt. No. 47). On July 27, 2020, the defendants in that case filed a pleading entitled "Suggestion of Bankruptcy" (D.N.J. Dkt. No. 58) that resulted in a stay of all proceedings in that case being entered the next day, July 28, 2020 (D.N.J. Dkt. No. 59). The case remains stayed as of the date of this Opinion.

- 2. David Jaffe previously served as the Chief Executive Officer of Debtors, while Robert Giammatteo previously served as Debtors' Chief Financial Officer. Both Jaffe and Giammatteo left their employment with Debtors several months before Debtors filed for bankruptcy. (USTAPP 0929, 1030.)
- 3. On July 23, 2020, Debtors filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. (USTAPP 0001-18.)
- 4. With the Bankruptcy Court's approval, Debtors consummated three transactions involving the sale of their businesses. On September 24, 2020, the Bankruptcy Court approved the sale of Debtors' Catherines enterprise. On November 12, 2020, the Bankruptcy Court approved the sale of Debtors' Justice enterprise. On December 8, 2020, the Bankruptcy Court approved the sale of Debtors' remaining businesses, including the sale of the Lane Bryant brand and the Premium business segment, which included Ann Taylor, LOFT, and Lou & Grey, to buyer Premium Apparel LLC. The last of these sales closed on December 23, 2020. These sales consisted of substantially all of the Debtors' assets. (Decl. of Carrie W. Teffner in Supp. of Confirmation of the Amended Joint Chapter 11 Plan ("Teffner Decl.") ¶ 5 (USTAPP 2318-2335).) The sale of the Debtors' Premium and Lane Bryant business resulted in Debtors receiving approximately \$472 million in net cash proceeds. (Decl. of William Kosturos in Supp. of Confirmation of the Amended Joint Chapter 11 Plan ("Kosturos Decl.") ¶ 5 (Dkt. No. 1761, In re Retail Group, Inc., Case No. 20bk33113 ("Bankr. Dkt.")).)
- 5. As a result of the sale of its assets, all that was left for the reorganization after December 23, 2020, was the distribution of Debtors' remaining estate cash. (Teffner Decl. ¶5.) By February 22, 2021, the Debtors had sold substantially all of their assets and all that remained was to distribute cash proceeds in accordance *678 with the terms of the Plan. (Teffner Decl. ¶30.)
- 6. The Reorganization Plan reflects a global resolution with the Creditors' Committee and contemplates payment in full in cash of all allowed administrative and priority claims. The Reorganization Plan had the support of 97% of the Term Lenders. (Teffner Decl. ¶ 5.)
- 7. The Reorganization Plan resulted from the collaborative efforts between Debtors, their advisors and legal counsel, and their stakeholders. The Amended Plan reflects the

wind down process and maximizes value to the Debtors' stakeholders. (Teffner Decl. ¶ 26.)

- 8. The Reorganization Plan contains third-party releases, an exculpation provision, and an injunction provision. According to Ms. Teffner, these provisions were the product of extensive good faith, arm's-length negotiations and were material inducements for the parties to enter into the comprehensive settlement embodied in the Plan. (Teffner Decl. ¶ 41.) The negotiations involved the Debtors and their lenders. (Tr. of Feb. 25, 2021 Hr'g ("Confirm. Tr.") at 22:24-25 (USTAPP 2673-2836).) None of the putative members of the securities fraud class action participated in the negotiation. And, Ms. Teffner acknowledged that none of the Releasing Parties had a seat at the table during the negotiations. (Confirm. Tr. at 23:5-10.)
- 9. David Jaffe and Robert Giammatteo did not participate in the negotiations involving the Third-Party Releases. Furthermore, the Third-Party Releases as they related to Jaffe and Giammatteo were not material inducements for the comprehensive settlement for the Reorganization Plan. (Confirm. Tr. at 23:11-24:2.). Moreover, neither Jaffe nor Giammatteo participated at all (directly or indirectly) in the Debtors' Chapter 11 process. Indeed, they were no longer employed by Debtors at the time of the reorganization. (Confirm. Tr. at 26:10-21.) Consequently, neither Jaffe nor Giammatteo played an integral (or any) role in the formulation and negotiation of the Debtors' plan. (Confirm. Tr. at 34:9-16; 48:20-23.) The Court therefore finds that the releases for Jaffe and Giammatteo were not integral to the reorganization.
- 10. The negotiations surrounding the Third-Party Releases were focused on all existing and prior officers and directors (including Jaffe and Giammatteo) and were designed to be broad. (Confirm. Tr. at 27:11-12; 32:23-25.) Ms. Teffner did not know whether the Third-Party Releases covered former employees and consultants. (Confirm. Tr. at 41:3-16.) Because the negotiations surrounding the Third-Party Releases were addressed to only officers and directors, the Third-Party Releases exceeded the terms of the negotiations.
- 11. At the time of the reorganization, Debtors had Director & Officer liability insurance coverage of at least \$50 million. (Confirm. Tr. at 29:1-31:4.) No evidence exists in the record that any of the claims released by the Third-Party

Releases would exceed the D&O insurance coverage and thereby cause a financial depletion of the estate.

- 12. The Third-Party Releases were designed to limit time spent defending any type of litigation, which would deplete assets and resources of the estate. (Confirm. Tr. 33:19-24.) The failure to approve the Third-Party Releases included in the Reorganization Plan could potentially increase the time and expense of the Debtors' wind-down process to the detriment of the Debtors' stakeholders. According to Ms. Teffner, the *quid pro quo* for the contributions, concessions *679 and support offered by the Released Parties was the Third-Party Releases. (Teffner Decl. ¶ 45.)
- 13. Debtors created a Special Committee that consisted of Mr. Begeman and one other disinterested director. (Decl. of Gary D. Begeman in Supp. of Confirmation of Amended Joint Chapter 11 Plan ("Begeman Decl.") ¶ 1 (Bankr. Dkt. No. 1759).) The purpose of the Special Committee was to conduct and oversee an investigation into historical transactions and evaluate any proposed release of any claims or causes of actions by Debtors in connection with a future transaction. The Special Committee retained Kirkland & Ellis (Debtors' counsel) to investigate potential causes of action that the Debtors could bring against any of the Related Parties during a six-year lookback period. (Begeman Decl. ¶¶ 6-8.) The investigation found no material claims in favor of the Debtors. (Begeman Decl. ¶ 9.)
- 14. After an extensive investigation, the Debtors were unable to uncover any material claims or causes of actions that could be brought against the Releasing Parties, and it is unlikely that the Debtors would recover material amounts, if any, from the Releasing Parties. (Teffner Decl. ¶ 42.) As such, the release by the Released Parties of claims against the Releasing Parties (described as the "mutual release" in this appeal) has no value and is fictional.
- 15. Mr. Begeman also reviewed the pending securities fraud class action filed in the District of New Jersey against the Debtor and its former directors and officers (Jaffe and Giammatteo) in Case No. 2:19cv12529. The Special Committee (Mr. Begeman and one other disinterested director) determined that the claims in the class action lacked merit and had no material value as related to the Debtors' estates. (Begeman Decl. ¶ 14.) Notably, the Bankruptcy Court did not accept this as an expert opinion; instead, it only received it as a report from the Special

Committee. (Confirm. Tr. at 12:10-18.) This Court gives no credit to Mr. Begeman's assessment for this reason.

16. This Court explicitly rejects the Bankruptcy Court's finding that the Third-Party Releases were consensual. (Bankr. Confirm. Op. at 31.) Instead, the Court finds the Third-Party Releases to be nonconsensual both as a matter of fact and as a matter of law. In terms of factual grounds, the Bankruptcy Court's opt-out notice was directed only to the putative class members in the securities fraud case. The Bankruptcy Court made no effort to provide notice and obtain consent from the numerous other Releasing Parties as described in the Third-Party Releases.

17. As to the putative class members in the securities fraud case, the record fails to establish that any consented to the release of their claims against Jaffe and Giammatteo. Debtors used Prime Clerk to ensure to the best of their ability to get access to putative members of the class action and to distribute the notices to the putative members. (Confirm. Tr. 21:3-16.) Prime Clerk worked with third parties to attempt to identify putative members of the class action and then to communicate the Notice to them. (Decl. of Craig E. Johnson of Prime Clerk LLC in Supp. of the Debtors' Objection to Securities Lead Plaintiffs' Motion for Entry of an Order Authorizing Lead Plaintiffs to Opt Out of Third-Party Releases on Behalf of the Class ("Johnson Decl.") ¶¶ 7-9 (Bankr. Dkt. No. 947).) Prime Clerk sent the notice to approximately 300,000 individuals; however, the record contains no information about the success of their efforts to reach this *680 group. (Bankr. Confirm. Op. at 13.) Indeed, Prime Clerk received only 596 opt-outs, which corresponds to 0.2% of those targeted. (Confirm. Tr. at 52:22-24.) The Court therefore finds that this effort was insufficient to establish notice of the optout provision in the Notice. Further, the record lacks any information establishing as a matter of fact that any of the targeted recipients of the Notice affirmatively consented to the release of their claims as provided in the Third-Party Release.

- 18. As to the shareholders who were putative class members in the securities fraud action, those who were deemed to have opted out did not receive anything of value for their releases. (Confirm. Tr. 18:13-22.)
- 19. There is no evidence in the record of any evaluation of any other potential claims that the Releasing Parties could have brought against the Debtors other than the securities fraud class action filed in the District of New Jersey, nor

does the record contain any effort to provide notice of the releases to any Releasing Party beyond the securities fraud class action.

20. According to Ms. Teffner, the Exculpation Provision resulted from good faith, arm's-length negotiations and was designed to protect those who served and assisted with the restructuring process, including those who did not necessarily owe a fiduciary duty to the Debtors. (Teffner Decl. ¶ 47.)

Against this factual backdrop, the Court will now turn its attention to the propriety of the Third-Party Releases.

D. The Application of *Behrmann* to the Third-Party Releases

In addition to the factual and constitutional defects in the approval of the Third-Party Releases outlined above, Appellants argue that the Bankruptcy Court erred in approving the Third-Party Releases under the applicable standards in the Fourth Circuit for approving nonconsensual third-party releases as set forth in *Behrmann*. (Trustee Br. at 37; Appellants' Br. at 73.) Debtors respond that the Releasing Parties consented to the releases, rendering the *Behrmann* factors inapplicable. (Appellee Br. at 41.) Additionally, Debtors contend that the Third-Party Releases satisfy the *Behrmann* factors. (Appellee Br. at 75.)

Thus, beyond the *Stern* issues, this appeal boils down to two questions: (1) whether the Bankruptcy Court erred by finding the releases consensual, and (2) whether the Bankruptcy Court erred by failing to conduct the seven-factor *Behrmann* analysis. The Court finds that the Bankruptcy Court erred on both fronts.

1. Third-Party Releases and Behrmann Generally

As previously noted, some Courts of Appeal have held that bankruptcy courts lack the power to grant nonconsensual third-party releases of the kind approved here. The Fifth, Ninth and Tenth Circuits prohibit nonconsensual third-party releases. See, e.g., In re Pac. Lumber Co., 584 F.3d at 251-53; In re Lowenschuss, 67 F.3d at 1401-02; In re W. Real Estate Fund, Inc., 922 F.2d at 600-02. These Circuits generally base this prohibition on 11 U.S.C. § 524(e), which states that "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." See, e.g., In re Pac. Lumber Co., 584 F.3d at 252 ("In a variety of contexts, this court has held that Section

524(e) only releases the debtor, not co-liable third parties.") (collecting cases); *In re Am. Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989) ("We therefore conclude that the specific provisions of section 524 displace *681 the court's equitable powers under section 105 to order the permanent relief sought by American.").

Other Circuits have held that bankruptcy courts have the power to impose involuntary releases, but that such involuntary releases should be imposed in "only rare cases." See, e.g., In re Metromedia Fiber Network, Inc., 416 F.3d at 141-43 (holding that involuntary releases should only be approved if they form an important part of a reorganization plan, and that they are proper "only in rare cases"); In re Seaside Eng'g & Surveying, Inc., 780 F.3d at 1078 (permitting releases and bar orders but cautioning that they "ought not to be issued lightly, and should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts and circumstances"); In re Dow Corning Corp., 280 F.3d at 657-58 ("Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a nonconsenting creditor's claim is only appropriate in 'unusual circumstances.").

[54] The Fourth Circuit has joined the circuits that allow non-debtor releases, but only "cautiously and infrequently." *Behrmann*, 663 F.3d at 712. In *Behrmann*, the Fourth Circuit confirmed that it had previously "rejected the notion that 11 U.S.C. § 524(e) forecloses bankruptcy courts from releasing and enjoining causes of action against nondebtors." 663 F.3d at 710 (citing *In re A.H. Robins Co.*, 880 F.2d 694 (4th Cir. 1989)). It noted that it had "declined to retreat from this holding" in a subsequent opinion and then, again, rejected as "without merit" the "blanket assertion that equitable relief in the form of non-debtor releases is never permissible under the Bankruptcy Code." *Id.* In rejecting this blanket assertion, the Fourth Circuit adopted the Sixth Circuit's test for approving non-debtor releases outlined in *In re Dow Corning Corp.*: The Fourth Circuit quoted in full from *In re Dow Corning Corp.*:

We hold that when the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor:

(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;

- (2) The non-debtor has contributed substantial assets to the reorganization;
- (3) The injunction is essential to 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;
- (4) The impacted class, or classes, has overwhelmingly voted to accept the plan;
- (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
- (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full; and,
- (7) The bankruptcy court made a record of specific factual findings that support its conclusions.

Behrmann, 663 F.3d at 711-12 (quoting *In re Dow Corning Corp.*, 280 F.3d at 658).

[55] Given the dramatic effect of third-party releases and that they are to be approved only in unique circumstances, "the meaningful exercise of appellate review at a minimum requires that the court make specific factual findings in support of its decision to grant equitable relief." Id. at 712. Ultimately, the Fourth Circuit remanded *682 the case, because the bankruptcy court's conclusory statements regarding the factors "[were] meaningless in the absence of specific factual findings explaining why this is so." *Id.* at 713. Underscoring the point that non-debtor releases only have a place in unique circumstances, the Fourth Circuit found that the bankruptcy court's "conclusions could apply just as well to any number of reorganizing debtors." Id. Therefore, it remanded the case "to set forth specific factual findings supporting its conclusions" that the debtor's circumstances entitled it to the non-debtor releases. Id.

Following remand, a different bankruptcy judge found the releases unenforceable and the district court affirmed the bankruptcy court. *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 347 (4th Cir. 2014). The Fourth Circuit affirmed, concluding that the debtor had "failed to carry its burden of proving that the facts and circumstances of this case justify the Release Provision." *Id.* at 347.

2. The Interrelationship Between Stern and Behrmann

[57] [58] The exacting caution and detailed findings [56] demanded of a bankruptcy court in granting a non-debtor release in a unique circumstance stems from the constitutional limitations placed on the bankruptcy court's jurisdiction. As the Stern analysis demonstrates, the Constitution limits bankruptcy courts — as non-Article III courts — to adjudicating only matters integral to a bankruptcy proceeding. In essence, the Behrmann factors task a reviewing court with determining how integral the releases are to a bankruptcy plan. Indeed, one factor asks the court to consider whether the release "is essential to the reorganization" such that the "reorganization hinges on the debtor being free from indirect suits." Behrmann, 663 F.3d at 711-12. Another factor requires that the non-debtor "contributed substantial assets to the reorganization." Id. at 711. Yet another examines the identity of interests between the debtor and the third party and the extent to which the suit against the third party would deplete the assets of the estate. Id. Clearly, these factors ask the bankruptcy court to determine the extent of the entanglement between the released claim and the bankruptcy case. Likewise, a bankruptcy court determining whether it has "core" constitutional authority over a matter looks to the same relationship. See Allied Title Lending, LLC, 420 F. Supp. 3d at 448 ("A cause of action is constitutionally core when it 'stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." (quoting Stern, 564 U.S. at 499, 131 S.Ct. 2594).

The Third Circuit's decision in *In re Millennium Lab Holdings II, LLC* illustrates this connection between the *Stern* analysis and the *Behrmann*-type analysis, and stands in stark contrast to what occurred here. There, the court examined a release in the debtor's restructuring agreement that released the debtor's two primary shareholders from conduct that occurred before the restructuring agreement. 945 F.3d at 131. Eventually, the bankruptcy court confirmed the plan that included the releases, over a lender's objection. *Id.* at 132. The bankruptcy court and district court both overruled the lender's objection that *Stern* prohibited the confirmation of a plan releasing its claims, stating that *Stern* did not apply to plan confirmation proceedings. *Id.* at 133. The lender appealed to the Third Circuit.

On appeal, the Third Circuit affirmed the confirmation, but not because it determined that *Stern* did not apply to plan *683 confirmation proceedings. ¹² Rather, the Third

Circuit conducted an exhaustive discussion of *Stern* and the limitations that it places on the authority of bankruptcy courts. *Id.* at 133-37. It concluded its discussion as follows:

In sum, *Stern* teaches that the exercise of "core" statutory authority by a bankruptcy court can implicate the limits imposed by Article III. Such an exercise of authority is permissible if it involves a matter integral to the restructuring of the debtor-creditor relationship. And, in determining whether that is the case, we can consider the content of the "core" proceeding at issue.

Id. at 137.

Applying those principles, the Third Circuit concluded that the bankruptcy court possessed constitutional authority to confirm the plan with the releases. Borrowing from its Stern analysis, the court stated that "the question is whether," in examining the release provisions at issue, "the Bankruptcy Court was resolving a matter integral to the restructuring of the debtor-creditor relationship." Id. at 137. Although it did not apply the facts to explicit factors like courts in the Fourth Circuit must, the court's reasoning closely resembles the Behrmann factors. For example, the court relied on the contributions made by the released parties — \$325 million transfers of their equity to the lenders and how the restructuring could not have occurred without those contributions. Id. at 137. The court noted how the releases resulted from protracted arm's-length negotiations in exchange for the contributions that allowed the debtor to continue operating. In short, "[r]estructuring in this case was possible only because of the release provision." Id. Ultimately, because the "Bankruptcy Court's conclusion that the release provisions were integral to the restructuring was well-reasoned and well-supported by the record," the bankruptcy court "was constitutionally authorized to confirm the plan in which those provisions appeared." *Id.* at 140. But even then, the Third Circuit made clear that the situation was an outlier. Id. at 140 ("In short, our holding today is specific and limited. It is that, under the particular facts of this case, the Bankruptcy Court's conclusion that the release provisions were integral to the restructuring was well-reasoned and wellsupported by the record.").

[59] The Third Circuit's reliance on the detailed factual findings below supporting the releases underscore the importance of a bankruptcy court fully supporting its basis for approving a non-debtor release. The detailed factual findings in *In re Millennium Lab* further highlight the lack of factual findings in this case. Here, the Bankruptcy Court stated in conclusory fashion that the Third-Party Releases were

AMERICAN BANKRUPTCY INSTITUTE

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

integral to the Plan, but it based this only on the fact that the Plan stated as much. Thus, instead of making detailed factual findings as to whether unique circumstances warranted the inclusion of non-debtor releases, the Bankruptcy Court abdicated this crucial function to the negotiators of the Plan — the very negotiators who stood to benefit from the Releases. However, the Bankruptcy Court cannot delegate to private citizens the determination of whether a court has the constitutional power to approve the releases. Thus, the Bankruptcy Court's lack of explanation constitutes clear error, in addition to erring both factually and as a matter of law in *684 its determination that the parties' consent obviated the need to conduct the *Behrmann* analysis, as explained below.

3. Consent and the Behrmann Analysis

Debtors argue that *Behrmann* does not apply to consensual releases (Appellee Br. at 60), whereas the Trustee argues that consent does not obviate the need to conduct the *Behrmann* analysis. (Trustee Br. at 24.) Aside from adopting the Sixth Circuit's approach for *nonconsensual* releases, the Fourth Circuit has not spoken directly on whether the *Behrmann* analysis applies to consensual releases. Again, courts around the country have split on the issue.

Several courts have found that a party can consent to a thirdparty release and eliminate the need for a *Behrmann* analysis. For example, the Seventh Circuit has noted approvingly that "courts have found releases that are consensual and noncoercive to be in accord with the strictures of the Bankruptcy Code." In re Specialty Equip. Cos., Inc., 3 F.3d 1043, 1047 (7th Cir. 1993). Likewise, the United States Bankruptcy Court for the District of Maryland distinguished consensual releases from those requiring a Behrmann analysis, because "[i]t is well recognized that, where the application of the Dow Corning or other applicable factors leads to the conclusion that the third party releases should not be approved, the court can nevertheless approve the releases with the consent of the releasing parties." In re Neogenix Oncology, Inc., 508 B.R. 345, 361 (Bankr. D. Md. 2014). The Second Circuit has also indicated that "[n]ondebtor releases may also be tolerated if the affected creditors consent." In re Metromedia Fiber Network, Inc., 416 F.3d at 142. Similarly, the Northern District of Texas has noted that "[m]ost courts allow consensual nondebtor releases to be included in a plan." In re Wool Growers Cent. Storage Co., 371 B.R. 768, 775 (Bankr. N.D. Tex. 2007).

a. Failing to Opt Out Does Not Rise to the Level of Consent Required to Obviate *Behrmann*.

[60] Even if consent can obviate the need for a *Behrmann* analysis, the level of consent required to eliminate the need for a *Behrmann*-type analysis varies. Debtors contend that failing to opt out of a release evidences consent to that release. (Appellee Br. at 41.) The Trustee argues that the Bankruptcy Court erred in finding that this type of implied consent suffices. (Trustee Br. at 24.) The Court agrees with the Trustee as a matter of law and as a matter of fact (as previously determined).

The Fourth Circuit does not appear to have spoken on the issue of whether implied consent can give rise to a consensual non-debtor release. *See In re Neogenix Oncology, Inc.*, 2015 WL 5786345, at *5 (Bankr. D. Md. Oct. 1, 2015) ("The Fourth Circuit has not expressly faced the issue presented here, whether a 'consensual' third party release must be express or whether implied consent can be sufficient."). Other courts have diverged on whether implied consent can suffice for a release.

Some courts, like the District of New Jersey, look to the principles of contract law rather than the bankruptcy court's confirmation authority to conclude that the validity of the releases requires affirmative consent. For example, in *In re Congoleum Corp.*, the court determined that a creditor must have "unambiguously manifested assent to the release of the nondebtor from liability on its debt." 362 B.R. 167, 194 (Bankr. D.N.J. 2007). Likewise, in *In re Arrowmill Development Corp.*, the court held that it was "not enough for a creditor to abstain from voting for a plan, or even *685 to simply vote 'yes' as to a plan." 211 B.R. 497, 507 (Bankr. D.N.J. 1997).

Yet, other courts have found that a creditor must individually consent by voting in favor of the plan. In *In re Coram Healthcare Corp.*, the court stated that "to the extent creditors or shareholders voted in favor of the Trustee's Plan, which provides for the release of claims they may have against the Noteholders, they are bound by that." 315 B.R. 321, 336 (Bankr. D.Del. 2004). Likewise, in *In re Washington Mutual, Inc.*, the court found the opt-out mechanism in the plan insufficient to support the third-party releases with respect to the parties who did not return a ballot. 442 B.R. 314, 355 (Bankr. D. Del. 2011).

However, other courts have determined that failure to return a ballot constitutes consent to a third-party release when the creditor received notice of implications of releasing parties. For example, in *In re Indianapolis Downs, LLC*, the court found that providing an opportunity to opt out along with detailed instructions for how to opt out warranted approval of the releases. 486 B.R. 286, 305-06 (Bankr. D. Del. 2013). However, the court allowed the "deemed" acceptance by the unimpaired creditors, because "these creditors are being paid in full and have therefore received consideration for the releases." *Id.* at 305. Likewise, in *In re Spansion, Inc.*, the court found that parties who had accepted the plan and not opted-out would be bound by the release. 426 B.R. 114, 144 (Bankr. D. Del. 2010).

Still, other courts have allowed implied consent releases. In *In re DBSD North America, Inc.*, the court approved third-party releases when the releasing parties received adequate notice of the release and they had an opportunity to opt out of the release. 419 B.R. 179, 218-19 (Bankr. S.D.N.Y. 2009); *see also In re Calpine Corp.*, 2007 WL 4565223 (Bankr. S.D.N.Y. Dec. 19, 2007) ("[parties] choosing not to opt out of the releases were given due and adequate notice that they would be granting the releases by acting in such a manner"). Similarly, in *In re Conseco, Inc.*, the court found that impaired creditors who did not opt out had impliedly consented to the releases. 301 B.R. 525, 527-28 (Bankr. N.D. Ill. 2003).

Debtors advance this last approach by comparing the optout provisions to contract law and class action procedures. (Appellee Br. at 65.) However, both comparisons cut sharply against their argument.

i. Contract Law Does Not Support Consent by Failure to Opt Out.

First, contrary to Debtors' statement that "actual principles of contract law have long provided that the manifestation of assent may be made wholly by failure to act" (Appellee Br. at 65), black letter contract law dictates otherwise. *See Meekins v. Lakeview Loan Servicing, LLC*, 2020 WL 1922765, at *4 (E.D. Va. Apr. 21, 2020) ("A party's silence, however, is insufficient to show its intention to be bound by the terms of a contract.") (quotations omitted). Indeed, in one of the cases cited by Debtors for its acceptance-by-silence proposition, the First Circuit stated, "it's basic contract law that an offeror cannot unilaterally impose on another party the obligation to respond and reject their offer." *Rivera-Colon v. AT&T*

Mobility Puerto Rico, Inc., 913 F.3d 200, 211 (1st Cir. 2019) (citing 1 Corbin on Contracts § 3.19 (2018) ("It should here be plainly set forth that an offeror has no power to cause the silence of the offeree to operate as an acceptance when the offeree does not intend it to do so."); 2 Williston on Contracts § 6:50 (4th ed. 1993) ("Merely sending an unsolicited offer does not impose upon the party receiving it any duty to speak or deprive the party of its privilege of remaining silent *686 without accepting.")). Limited exceptions to this rule exist, such as previous dealings or when an offeror gives the offeree reason to believe that silence or inaction will manifest assent, and the offeree remains silent or inactive with the intent to accept the offer. Restatement (Second) of Contracts § 69(1)(b). However, neither Debtors nor the Bankruptcy Court identified any facts that would support the application of an exception to the general rule of contracts that silence cannot manifest assent. Nor does the record reveal any such facts. Indeed, the Court has already found as a matter of fact that consent did not occur. Accordingly, any attempt to claim that contract law supports a finding of consent to third-party releases based on inaction rings hollow.

ii. Class Action Law Does Not Support Finding Consent by Failing to Opt Out.

[61] Likewise, Debtors' comparison to class actions falls short of providing support of their contention that a failure to opt out constitutes consent to the releases. In fact, the comparison to class action litigation highlights the impropriety of finding releases consensual based merely on a failure to opt out. True, as noted by Debtors, courts (notably, Article III judges) may bind absent class members to a judgment so long as they provide them notice of the action and the opportunity to either opt out or participate. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 86 L.Ed.2d 628 (1985). But to do so, courts must ensure that the class action complies with the unique requirements of Rule 23 of the Federal Rules of Civil Procedure.

[62] [63] Importantly, Rule 23(a), in relevant part, allows an individual to sue on behalf of other class members only if he will "fairly and adequately protect the interests of the class" and his claims "are typical of the claims or defenses of the class." Fed. R. Civ. P. 23(a)(3)-(4). Further, the class must be specifically defined to identify the class members and the class claims. Fed. R. Civ. P. 23(c)(1)(B). Moreover, the court must appoint class counsel that can best "represent the interests of the class." Fed. R. Civ. P. 23(g). Indeed, the

court *must* appoint class counsel to represent the class, as pro se litigants cannot represent absent class members. *See Oxendine v. Williams*, 509 F.2d 1405, 1407 (4th Cir. 1975) ("Ability to protect the interests of the class depends in part on the quality of counsel, and we consider the competence of a layman representing himself to be clearly too limited to allow him to risk the rights of others.") (internal citations omitted). And, the presiding court bears responsibility for ensuring compliance with all of the above requirements. Most, if not all, of these requirements become heavily litigated throughout the life of a class action.

None of these protections exist in the context of a non-debtor release in a bankruptcy action. First and foremost, no party litigates on behalf of the absent releasing party. No party with a typical claim has a duty to ensure that he fairly and adequately represents the best interests of the absent releasing party. Moreover, the absent releasing party does not enjoy counsel that will represent his best interests in his stead. Indeed, the facts of this case highlight that distinction. The Bankruptcy Court expressly rejected the ability of certain absent releasing parties to have a party and counsel represent their best interests. Yet, the Bankruptcy Court still sought to extinguish their claims.

[65] Similarly, and importantly, any class settlement that would bind absent class members requires court approval. Fed. R. Civ. P. 23(e). After giving notice to all class members of the proposed settlement, *687 the court may only approve the settlement "after a hearing and only on finding that it is fair, reasonable, and adequate" taking into account whether "(A) the class representatives and class counsel have adequately represented the class; (B) the proposal was negotiated at arm's length; (C) the relief provided for the class is adequate; and (D) the proposal treats class members equitably relative to each other." Fed. R. Civ. P. 23(e)(2). "The inquiry appropriate under Rule 23(e) ... protects unnamed class members from unjust or unfair settlements affecting their rights" Amchem Prod., Inc. v. Windsor, 521 U.S. 591, 623, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997) (internal quotations omitted). And it is an Article III judge, acting with all of their powers and protections as described in Stern, that approves the settlement.

Conversely, if mere failure to opt out obviates the need to conduct a *Behrmann* analysis, then no court carries an obligation to ensure the fairness, reasonableness and adequacy of the relief afforded the absent releasing parties. The *Behrmann* analysis at least provides some oversight that

resembles the scrutiny given by a court to class settlement under Rule 23, even if it falls short of ensuring that the release of the claims is fair, reasonable and adequate. Again, the facts of this case highlight the need for scrutiny of what Debtors call a "settlement" of the released claims. No court would find this "settlement" fair, reasonable and adequate under Rule 23, as application of those factors demonstrate. No party or counsel represented the interests of the class, much less represented them adequately. The settlement of the released claims did not result from any negotiation with the Releasing Parties, much less one that occurred at arm's length. Instead, it appears that negotiations only occurred between the individuals and entities that would benefit from releases in an effort to shield themselves from any liability, not those who would confer the benefit in exchange for some other benefit.

Along those lines, the settlement of the released claims provides no relief to the Releasing Parties, much less adequate relief. The fact that the Releasing Parties also receive a release provides nothing more than illusory consideration. The Court cannot envision a potential claim that a former officer or director of Debtors could have against a former shareholder that would give a mutual release any real value. Indeed, the Court has already found as a matter of fact that the mutual release lacked any value and was purely fictional.

The protections provided to absent class members under Rule 23 highlight the lack of protections provided to absent releasing parties in this context. Moreover, the comparison to class actions also demonstrates the due process issues that result from releasing a claim based only on the failure to opt out

b. Releasing These Claims Raises Serious Due Process Concerns.

Third-party releases in bankruptcy actions based only on a failure to opt out also raise serious due process concerns, because they lack the critical due process protections of Rule 23. See Bell v. Brockett, 922 F.3d 502, 511 (4th Cir. 2019) ("Rule 23's adequacy requirements provide critical safeguards against the due process concerns inherent in all class actions."). In the seminal case on due process in class actions, the Supreme Court held that when "a fully descriptive notice is sent [by] first-class mail to each class member, with an explanation of the right to 'opt out,' [that procedure] satisfies due process" even if the absent class member would

2022 SOUTHEAST BANKRUPTCY WORKSHOP

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

be bound *688 absent an affirmative opt in. *Shutts*, 472 U.S. at 812, 105 S.Ct. 2965.

[66] However, the Supreme Court's basis for this holding underscores the lack of due process present here. First, "[t]he notice must be the best practicable, reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Id.* at 812, 105 S.Ct. 2965 (quotations omitted). Second, the "notice should describe the action and the plaintiffs' rights in it." *Id.* Third, "an absent plaintiff [must] be provided with an opportunity to remove himself from the class by executing and returning an 'opt out' or 'request for exclusion' form to the court." *Id.* Fourth, "the Due Process Clause of course requires that the named plaintiff at all times adequately represent the interests of the absent class members." *Id.*

[67] In this case, the Third-Party Releases fail three of the four elements required to afford due process. First, the Bankruptcy Court found the notice "sufficient." (Bankr. Confirm. Op. at 31.) But, "sufficient" falls short of the "best practicable, reasonably calculated" standard set forth by the Supreme Court. Although the Court will not now fully undertake the analysis of whether the notice constituted the "best practicable, reasonably calculated" notice "under the circumstances," it seems unlikely that the notice would meet that higher standard. Second, the notice did not describe the released claims or the rights given up by the absent Releasing Parties. Nor did it mention the only purported benefit (the illusory "mutual release") to the Releasing Parties as consideration for their release. Describing the bankruptcy action and generally stating that the absent party would release all claims does not identify the specific claims subject to release. It does not "describe the action and the plaintiffs' rights in it." The notice satisfies the third element of providing the absent Releasing Parties the opportunity to opt out. Finally, as discussed above, the absent class members had no one to adequately represent their interests. Accordingly, allowing the release of claims based only on the failure to opt out does not comport with due process.

In conclusion, the Court finds that the Bankruptcy Court erred both factually and legally in finding the Third-Party Releases to be consensual. Failure to opt out, without more, cannot form the basis of consent to the release of a claim. Whether the Court labels these "nonconsensual" or based on "implied consent" matters not, because in either case there is a lack of sufficient affirmation of consent. See

In re Neogenix Oncology, Inc., 2015 WL 5786345, at *6 ("Behrmann provides sufficient guidance on whether a court should approve a release for which there is insufficient affirmation of consent, whether the release is said to be 'nonconsensual' or based on 'implied consent.' "). And, it bears emphasizing again that Debtors' argument about consent focuses only on the pending securities fraud case in the District of New Jersey, which constitutes only the tip of the release iceberg, as the Third-Party Releases cover far more than a single case against two former officers. No argument about consent can be raised about all of the other Releasing Parties that the Bankruptcy Court never even considered.

Accordingly, the mandates of *Behrmann* unquestionably apply, and the Bankruptcy Court should have conducted the *Behrmann* analysis to determine if this case constitutes the rare case warranting such third-party releases.

4. The Bankruptcy Court's Error in Failing to Conduct a Behrmann Analysis

[68] *Behrmann* commands that a bankruptcy court may only grant nonconsensual *689 non-debtor releases "cautiously and infrequently." *Behrmann*, 663 F.3d at 712. Because only cases with unique circumstances warrant granting such releases, a bankruptcy court must make "specific factual findings" demonstrating why the debtor's circumstances entitle it to the benefit of the releases. *Id.* at 712-13.

[70] Here, the Bankruptcy Court failed to conduct any Behrmann analysis, precluding any meaningful appellate review. Indeed, the Bankruptcy Court addressed the Behrmann factors in a single footnote — again, a single footnote — that merely said: "were the Behrmann factors applicable to the Third-Party Releases, the Court would find the Behrmann factors were satisfied for the reasons stated in the Debtors' Memorandum of Law" (Bankr. Confirm. Op. at 38, n.28). It should be obvious that a court may not satisfy its judicial responsibilities by simply incorporating by reference a party's brief. Cuthbertson v. Biggers Bros., 702 F.2d 454, 458 (4th Cir. 1983) ("We have previously condemned the practice of adopting the prevailing party's proposed findings of facts and conclusions of law, and we repeat that admonition here."). As the Third Circuit reminded in Bright v. Westmoreland County, 380 F.3d 729 (3d Cir. 2004):

Judicial opinions are the core work-product of judges. They are much more than findings of fact and conclusions of law; they constitute the logical and analytical explanations of why a judge arrived at a specific decision. They are tangible proof to the litigants that the judge actively wrestled with their claims and arguments and made a scholarly decision based on his or her own reason and logic. When a court adopts a party's proposed opinion as its own, the court vitiates the vital purposes served by judicial opinions.

Id. at 732. And such a cursory consideration of the *Behrmann* factors disregards the Fourth Circuit's command to limit the use of third-party releases to the exceptional case warranting them.

Moreover, the vast Third-Party Releases broadly release a wide variety of claims, against a wide variety of individuals, held by a wide variety of individuals. The variety of claims released here necessarily means that the specific factual findings supporting the propriety of releasing each type of claim will also vary. Accordingly, the Court cannot conduct meaningful appellate review as a result of the Bankruptcy Court's failure to address that which has been released, setting forth the specific factual findings for each type of claim released. Meaningful review requires detailed findings of fact by the Bankruptcy Court. That did not happen here.

Indeed, the only identified claims released in this appeal are those against the Individual Defendants (Jaffe and Giammatteo) as asserted in the putative class action filed in the District of New Jersey. Yet, by way of example, they demonstrate the Third-Party Releases' inability to meet the *Behrmann* factors. A brief examination of the *Behrmann* factors as applied to these claims follows.

a. Identity of Interests

[71] [72] Under the first factor, "a court must consider whether there is an identity of interests — usually an indemnity obligation — between the debtor and the released parties," such that the "suit against the non-debtor may, in essence, be a suit against the debtor that risks depleting the assets of the estate." *Nat'l Heritage Found., Inc.*, 760 F.3d at 348 (cleaned up). Debtors claim that they had an indemnification obligation to the Individual Defendants. (Appellee Br. at 78-79.) But, Debtors have essentially liquidated and, therefore, it remains uncertain *690 whether Debtors have a continuing indemnification obligation to the

Individual Defendants. Moreover, the Court agrees with the Third Circuit's view in *In re Continental Airlines*:

We conclude that granting permanent injunctions to protect non-debtor parties on the bases of theoretical identity of interest alone would turn bankruptcy principles on their head. Nothing in the Bankruptcy Code can be construed to establish such extraordinary protection for non-debtor parties.

203 F.3d at 217. Consequently, this factor does not weigh in favor of the releases.

b. Substantial Contribution

The second factor requires Debtors "to demonstrate that the Released Parties made a substantial contribution of assets to its reorganization." Nat'l Heritage Found., Inc., 760 F.3d at 348. The record does not support that the Individual Defendants made any financial contribution to the reorganization or any other contribution. Indeed, the Court has already made a factual finding that the Individual Defendants played no role in the reorganization (they had already left Debtors' employment) and their releases were not integral to the reorganization. The fact that they also provided releases to Debtors does not amount to a "substantial contribution of assets," especially given the illusory nature of the releases. Even if it could, the record does not support that the releases provided by the Individual Defendants could amount to a contribution of substantial assets. Accordingly, this factor weighs heavily against granting the release.

c. Essential to the Reorganization

[73] To satisfy the third factor, "a debtor must demonstrate that the non-debtor release is essential to its reorganization, such that the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor." *Id.* As an initial matter, Debtor largely liquidated, rather than reorganized. This alone cuts against the essential nature of the releases. The third and final asset sale transaction closed on December 23, 2020 — well before confirmation of the Plan. That the deals closed and the assets changed hands well before any release was finalized or went into effect demonstrates that the Plan does not hinge on the inclusion of the releases.

2022 SOUTHEAST BANKRUPTCY WORKSHOP

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

Moreover, the record does not reveal that the Plan would be doomed if the Individual Defendants did not obtain a release. Indeed, as previously noted, the releases of the Individual Defendants were not integral to the reorganization. And, the Court cannot discern any reason why a lack of release for the Individual Defendants would prove fatal to the implementation of the Plan. Accordingly, this factor also weighs heavily against granting the release.

d. Approval by the Affected Class

The fourth factor requires Debtor "to prove that the class or classes affected by the Release Provision overwhelmingly voted in favor of the Plan." *Id.* at 350. Here, the Class Members, as a class receiving nothing under the Plan, were deemed to reject the Plan as a matter of law. 11 U.S.C. § 1126(g). Debtors claim that the small number of opt outs satisfy this prong. However, for the reasons stated above, the Court gives little weight to the failure to opt out of the Plan and will not view it as analogous to an affirmative vote in favor of the Plan. Therefore, this factor also weighs heavily against the release.

e. Mechanism to Pay Substantially All of the Class Affected

Under the fifth factor, the court considers "whether the debtor's reorganization *691 plan provides a mechanism to consider and pay all or substantially all of the class or classes affected by the non-debtor release." *Id.* at 350. Here, the Plan does not create a separate fund to pay the claims released or provide any other mechanism to consider or pay the securities claims. Indeed, the Third-Party Releases are so broad that there has been no effort to even discern the full extent of the claims. Because the Plan extinguishes these claims entirely without giving any value in return, this weighs strongly against granting the Release. *See id.* at 351 (concluding that "the absence of such a [channeling fund] can weigh against the validity of a non-debtor release, especially when the result is that the impacted class's claims are extinguished entirely").

f. Opportunity to Recover

The final substantive factor "is whether the plan provides an opportunity for those who chose not to settle to recover in full." *Id.* at 351. Here, the Plan provides the class members an

opportunity to opt out of the Release and pursue the Securities claims. However, given the deficient notice, the Court has already found that here, as a matter of fact, notice did not occur. Accordingly, this factor also weighs against granting the Release.

In sum, the *Behrmann* factors clearly weigh against releasing the Individual Defendants from liability in the Securities Claims. As with the Stern analysis, these claims have no meaningful connection to the bankruptcy case. Indeed, the Court has already made a factual finding that these releases were not integral to the Plan. Therefore, they do not implicate the unique circumstances that would warrant a bankruptcy court — or, at least one that grants non-debtor releases only cautiously and infrequently — to release these claims as part of the bankruptcy proceedings. Debtors' claim that "virtually every confirmed plan in every complex bankruptcy case [in the Eastern District of Virginia] includes consensual thirdparty release provisions of this variety" (Appellees' Br. at 8), harms, rather than helps, its argument. That the Bankruptcy Court grants such non-debtor releases as a matter of course, rather than "cautiously and infrequently" and only when warranted by unique circumstances, underscores the lack of specific factual findings supporting the releases here.

For these reasons, the Bankruptcy Court clearly erred in finding that the releases satisfied the *Behrmann* factors. Consequently, the Third-Party Releases must be voided and rendered unenforceable. The Court will now turn to the impact on the Plan of the voiding of the Third-Party Releases and whether the voided releases may be severed from the Plan.

E. Severability

[74] The Court finds that it can sever the unenforceable releases from the Plan. Debtors argue that the nonseverability provision renders the Third-Party Releases nonseverable from the Plan. (Appellee Br. at 34-35.) The provision relied upon by Debtors follows in its entirety:

If, before Confirmation, any term or provision of the Plan is held by the Bankruptcy Court to be invalid, void, or unenforceable, the Bankruptcy Court shall have the power to alter and interpret such term or provision to make it valid or enforceable to the maximum extent practicable, consistent with the original purpose of the term or provision held to be invalid, void, or unenforceable, and such term or provision shall then be applicable as altered or interpreted. Notwithstanding any such holding, alteration,

or interpretation, the remainder of the terms and provisions of the Plan will remain in full force and *692 effect and will in no way be affected, impaired, or invalidated by such holding, alteration, or interpretation. The Confirmation Order shall constitute a judicial determination and shall provide that each term and provision of the Plan, as it may have been altered or interpreted in accordance with the foregoing, is: (1) valid and enforceable pursuant to its terms; (2) integral to the Plan and may not be deleted or modified without the Debtors' or the Reorganized Debtors' consent, as applicable; and (3) nonseverable and mutually dependent.

(the "Nonseverability Provision") (USTAPP 2528).) Boiled down to its essence, the Plan explicitly provides that the Bankruptcy Court could sever any provision before confirmation without it affecting the rest of the Plan, but following confirmation all provisions are integral and only the Debtors can consent to severance of a particular provision. It does not explain why each provision becomes integral only upon confirmation.

As explained above, after having found a Stern violation and vacated the Confirmation Order, the Plan now comes before the Court under Rule 8018.1 "as proposed findings of fact and conclusions of law." Therefore, the Court steps into the shoes of the Bankruptcy Court in terms of the Nonseverability Provision. That is, the first half of the Nonseverability provision remains the operative provision, and the Plan itself has not declared the Third-Party Releases nonseverable. Consequently, the Plan provides that the Court should sever the voided Third-Party Releases from the Plan. And the Court will do so. However, just as the Court would not find the Third-Party Releases nonseverable after confirmation based only on the boilerplate Nonseverability Provision, it will not rely solely on the Nonseverability Provision to find the provisions severable now that the Plan returns to the preconfirmation phase. Instead, the Court will analyze the law surrounding severability and the record to determine that it can sever these Third-Party Releases that lack any connection to the reorganization.

1. The Nonseverability Provision's Textual Support for Severability

[75] As described above, the Nonseverability Provision provides that, before confirmation, the Plan remains in full effect in the event that the Bankruptcy Court finds any provision unenforceable. Having now vacated the

Confirmation Order, the Court steps into the shoes of the Bankruptcy Court before confirmation, when the parties agreed that the Third-Party Releases could be severed. Yet, Debtors maintain that the Nonseverability Provision reinforces that the Third-Party Releases carry too much import in the Plan for it to survive without the Releases.

However, the contradictory text and operation of the Nonseverability Provision belies the argument that the Plan cannot survive without the Third-Party Releases. The Nonseverability Provision expressly provides that, before confirmation, the Bankruptcy Court could find the Third-Party Releases (or any provision) unenforceable, as the Court is now doing. In the event of such a holding, the Plan would "in no way be affected, impaired, or invalidated." The fact that the Plan would have survived if the Bankruptcy Court had severed the Third-Party Releases just before confirmation, without any further changes, demonstrates that the Third-Party Releases are not inextricably tied to the rest of the Plan. Therefore, just as the Bankruptcy Court could sever the Third-Party Releases before confirmation, this Court can sever the Third-Party Releases after vacating the Confirmation Order.

*693 Likewise, the Nonseverability Provision provides that a provision of the Plan can be deleted with Debtors' consent. Again, this demonstrates that the Plan could survive in the absence of any particular provision. Debtors attempted to reserve for themselves the right to sever provisions of the Plan — without the consent of any other affected parties while arguing here that the Court lacks the same authority to sever legally unenforceable provisions. This confirms that the Nonseverability Provision amounts to nothing more than a hollow attempt to evade judicial review of the Third-Party Releases. The negotiating parties here have attempted to release a wide variety of claims of a wide variety of absent and nonconsenting individuals and then use a boilerplate Nonseverability Provision to constrain Article III review of those releases. The Court cannot let such gamesmanship occur. Therefore, the Court will look to the record in determining that the releases do not form an integral part of the Plan and, consequently, the Court may sever this provision without upending the entire Plan.

2. The Importance of the Provision to the Plan's Determination of Severability

[76] [77] [78] In determining severability, courts must look to the evidence in the record and not simply whether

the parties state in a conclusory fashion that the provision cannot be severed. As the Second Circuit has explained, "normally a nonseverability clause standing on its own cannot support a finding of equitable mootness." In re Charter Commc'ns, Inc., 691 F.3d 476, 485 (2d Cir. 2012). The Second Circuit's reasoning in the equitable mootness context provides sound guidance in examining severability generally. The Second Circuit explained that "[a]llowing a boilerplate nonseverability clause, without more, to determine the equitable mootness question would give the debtor and other negotiating parties too much power to constrain Article III review," and would "moot virtually every appeal where a stay had not been granted." Id. Importantly, "[w]hile a nonseverability clause may be one indication that a particular term was important to the bargaining parties, a district court cannot rely on such a clause to the exclusion of other evidence." Id.

The Second Circuit ultimately found the release provisions nonseverable, but only because courts below "did not rest [their] decision exclusively on the nonseverability clause." *Id.* at 486. Instead, it relied on specific testimony regarding the importance of the releases. *Id.* This included an examination of how the releases induced a specific released party to settle and an explanation of why the plan required that released party's contribution. *Id.* The court relied on evidence that "these provisions could not be excised without seriously threatening Charter's ability to re-emerge successfully from bankruptcy," because the parties would need to reenter negotiations. *Id.*

Other circuits, including the Fourth Circuit, have followed a similar approach in looking to the facts to determine severability. For example, in Behrmann, the Fourth Circuit rejected the equitable mootness argument based not only on a severability provision, but also on the absence of any factual support that the releases "[were] important to the overall objectives of the Plan" as argued. 663 F.3d at 714. The debtor had "failed to demonstrate how the relief requested by Appellants would jeopardize the success of the Confirmed Plan." Id. After explaining that the importance of the releases to the overall plan lacked factual support, the Fourth Circuit "also note[d]" the existence of a severability provision allowing provisions to be severed, like the posture here *694 now — "suggests that the plan would remain viable absent the Release Provisions." Id. Thus, the Fourth Circuit relied on the facts to determine the importance of a provision to the plan, not just the provisions in the plan addressing severability.

Similarly, in the *In re Continental Airlines* case, the Third Circuit rejected an argument as to the essential nature of third-party releases to a plan where the debtors presented "[n]o evidence or arguments ... that Plaintiffs' appeal, if successful, would necessitate the reversal or unraveling of the entire plan of reorganization." 203 F.3d at 210. It explained that the debtors had provided no evidence that "investors and creditors, in deciding whether to support the Continental Debtors' plan, ever considered Plaintiffs' claims." *Id.* The Third Circuit ultimately invalidated the releases. *Id.* at 217-18.

3. Other Areas of the Law's Support for Focusing on the Provision's Importance to the Plan

[80] This focus on the overall importance of the provision proposed to be severed finds support in other areas of severability. For example, when confronted with an unconstitutional provision in a statute, courts typically "sever] any problematic portions while leaving the remainder intact." Free Enter. Fund v. Pub. Co. Acct. Oversight Bd., 561 U.S. 477, 508, 130 S.Ct. 3138, 177 L.Ed.2d 706 (2010). This presumption operates in the presence or absence of a severability provision. See Barr v. Am. Ass'n of Pol. Consultants, Inc., — U.S. —, 140 S. Ct. 2335, 2352-53, 207 L.Ed.2d 784 (2020) ("Even if the severability clause did not apply to the governmentdebt provision at issue in this case (or even if there were no severability clause in the Communications Act), we would apply the presumption of severability as described and applied in cases such as Free Enterprise Fund. And under that presumption, we likewise would sever the 2015 governmentdebt exception, the constitutionally offending provision.").

[81] [82] [83] With this presumption in mind, courts look to the importance of the provision to the overall statute. "The more relevant inquiry in evaluating severability is whether the statute will function in a manner consistent with the intent of Congress." *Alaska Airlines, Inc. v. Brock*, 480 U.S. 678, 685, 107 S.Ct. 1476, 94 L.Ed.2d 661 (1987). Indeed, if "the unconstitutionality of a part of an Act does not necessarily defeat or affect the validity of its remaining provisions," then courts will invalidate only the unconstitutional portion. *Free Enter. Fund*, 561 U.S. at 508, 130 S.Ct. 3138. Thus, courts look to whether severing the offending provision would upend the entire statute and, if not, they default to severing the provision.

[87] Likewise, contract law supportsbroad releases. (Confirm. Tr. at 36:1-4.) Again, she admitted [84] [85] [86] looking to the overall importance of the unenforceable provision. As the Fourth Circuit has described Virginia contract law: "Generally, when a contract covers several subjects, some of whose provisions are valid and some void, those which are valid will be upheld if they are not so interwoven with those illegal as to make divisibility impossible." Alston Studios, Inc. v. Lloyd V. Gress & Assocs., 492 F.2d 279, 285 (4th Cir. 1974). Similarly, "Delaware law is clear that an invalid term of an otherwise valid contract, if severable, will not defeat the contract. Thus, a court will enforce a contract with an indefinite provision if the provision is not a material or essential term." VICI Racing, LLC v. T-Mobile USA, Inc., 763 F.3d 273, 284-85 (3d Cir. 2014) (cleaned up). Thus, when faced with an unenforceable provision in a contract, courts will look to whether severing the provision will upset the entire contract.

*695 4. The Evidence in This Case Supports Severing the **Third-Party Releases**

Applying these principles, the Court finds that severing the Third-Party Releases at this stage would not upset the viability of the Plan. In fact, the evidence demonstrates otherwise. Indeed, Carrie Teffner testified that, as of February 22, 2021, "Debtors have sold substantially all of their assets and all that remains is to distribute cash proceeds in accordance with the terms of the plan." (Teffner Decl. ¶ 30.) To that end, the three main sales of the assets had all closed months before the confirmation hearing. No evidence exists that severing the Third-Party Releases would upset these already-closed sales, require Debtors to return any of the funds generated by the sales or disrupt the distribution of the cash proceeds.

Teffner further testified that the various release provisions "are the product of extensive good faith, arm's-length negotiations and were material inducements for the parties to enter into the comprehensive settlement embodied in the plan." (Teffner Decl. ¶ 41.) Yet, this "arm's-length" negotiation occurred without the Releasing Parties having a seat at the negotiating table. Teffner admitted as much during cross-examination during the Confirmation hearing. (Confirm. Tr. at 23:1-10.) Moreover, she did not describe how the releases operated as a material inducement for the parties to enter into the settlement, especially given that many of the parties did not enter into the settlement. Instead, she testified that it was the Debtors, not third parties, who sought the

as much on cross-examination. (Confirm Tr. at 23:21-24:2.) In fact, she admitted that with respect to her statement regarding the material inducement, "the third-party releases were addressed in totality with no specific individuals called out." (Confirm. Tr. 23:25-24:2.) The Court cannot agree that the Third-Party Releases provided a material inducement to such a broad array of individuals without examining the inducement to each individual. Additionally, Teffner admitted that the Releasing Parties had no participation in the bankruptcy process at all. (Confirm. Tr. at 26:10-14.)

Furthermore, Teffner claimed that not approving the Third-Party Releases "could potentially significantly increase the time and expense of the Debtors' wind down process, to the detriment of the Debtors' stakeholders." (Teffner Decl. ¶ 45.) On cross-examination, she expanded that this referred to the time and expense of engaging in discovery and defending litigation. (Confirm. Tr. at 33:19-22.) However, expending additional time and expense to respond to discovery does not amount to unwinding the Plan, especially with the presence of substantial insurance to offset certain litigation costs. Indeed, Debtors had in excess of \$50 million in insurance, and perhaps in excess of \$100 million dollars. (Confirm. Tr. 30:14-31:4.)

Critically, during the Confirmation Hearing, Teffner could not offer specific reasons why the Third-Party Releases comprised a necessary part of the Plan. (Confirm. Tr. at 36:1-4.) Instead, she offered only general statements that the overall intent of Debtors was to provide releases for everyone. (Confirm. Tr. at 36:1-4.) And she admitted that the negotiations focused only on past/current officers and directors, not the vast universe of Released Parties contained in the Third-Party Releases. (Confirm. Tr. at 27:19-24; 42:3-9.) She refused to answer whether the reorganization would fail absent the releases. *696 13 (Confirm. Tr. at 36:10-19.)

In fact, Teffner confirmed that the most important reasons for the inclusion of the Third-Party Releases — pushing the Plan to completion, playing an integral role in the bankruptcy, expending time and resources, and making concessions would not apply to individuals or entities that worked for Debtors before the bankruptcy filing. (Confirm. Tr. at 42:3-44:6.) Yet, the only addressed Released Parties involves two former executives (Jaffe and Giammatteo) who had left their employment with Debtors months before the bankruptcy and played no role in the reorganization.

In sum, the record contains no evidence of how the Third-Party Releases induced specific releasing parties to settle, or why the Plan required that Releasing Party's contribution. It contains no evidence as to why the Court could not excise the Third-Party Releases without seriously threatening Debtors' ability to re-emerge successfully from bankruptcy. Nor does the record suggest that the parties would need to reenter any negotiations. Indeed, Debtors have made clear that the Plan "is substantially consummated — and then some." (Appellee Br. at 30.) Simply saying that the Third-Party Releases form an integral part after confirmation of the Plan does not make it so. And, by saying the Third-Party Releases do not form an integral part of the Plan before confirmation, Debtors essentially admit that they do not form an integral part at any time

The Court will not allow parties who gifted themselves a release in the Plan to hold this appeal hostage with a Nonseverability Provision, especially when the parties have not articulated a sound basis for nonseverability. For these reasons, the Court has no difficulty in severing the voided Third-Party Releases from the Plan.

F. Equitable Mootness

Debtors also argue that the Court should dismiss this appeal on the grounds of equitable mootness. (Appellee Br. at 30.) The Court declines the invitation to use its equitable powers to ignore the serious errors that have occurred here.

1. Equitable Mootness Doctrine Generally

[88] [89] [90] [91] [92] "Equitable mootness pragmatic doctrine grounded in the notion that, with the passage of time after a judgment in equity and implementation of that judgment, effective relief on appeal becomes impractical, imprudent, and therefore inequitable." *In re Bate Land & Timber LLC*, 877 F.3d 188, 195 (4th Cir. 2017). The doctrine's application "is based on practicality and prudence, does not employ rigid rules, and requires that a court determine whether judicial relief on appeal can, as a pragmatic matter, be granted." *Id.* In making this determination, courts can examine the following relevant factors:

- (1) whether the appellant sought and obtained a stay;
- (2) whether the reorganization plan or other equitable relief has been substantially consummated;

- (3) the extent to which the relief requested on appeal would affect the success of the reorganization plan or other equitable relief granted; and,
- (4) the extent to which the relief requested on appeal would affect the interests of third parties.
- *Id.* The reviewing court has discretion whether to find an appeal equitably moot. *Behrmann*, 663 F.3d at 714 ("In sum, we *697 decline to exercise our discretion to dismiss this appeal as equitably moot."). And, notably, "equitable mootness applies to specific claims, not entire appeals and must be applied with a scalpel rather than an axe." *In re Charter Commc'ns, Inc.*, 691 F.3d at 481-82 (cleaned up).

[93] Before addressing the factors, the Court notes that four threshold issues weigh against a finding of equitable mootness. First and foremost, vacating the Confirmation Order undercuts the argument in support of equitable mootness. The Confirmation Order no longer constitutes a final judgment, such that the Court no longer faces "the passage of time after a judgment in equity and implementation of that judgment," *In re Bate Land & Timber LLC*, 877 F.3d at 195, that the equitable mootness doctrine is based upon. The inquiry could end here. However, the Court will continue its analysis of the equitable mootness doctrine and find that it does not apply even if the Confirmation Order had not been converted into a Report and Recommendation.

Second, the fact that the Trustee brings this appeal counsels against applying the equitable doctrine. The Trustee argues that equitable mootness should never apply against an appeal brought by the Government. (Trustee Reply at 30.) Although the Court need not adopt such an ironclad rule, the Court believes that equitable mootness should not lie against the Trustee under these or similar circumstances. See Off. of Pers. Mgmt. v. Richmond, 496 U.S. 414, 423, 110 S.Ct. 2465, 110 L.Ed.2d 387 (1990) ("But it remains true that we need not embrace a rule that no [equitable] estoppel will lie against the Government in any case in order to decide this case.").

[94] [95] As the Fourth Circuit has articulated, the equitable mootness doctrine applies especially "when a party, seeking a return to the status quo ante, sits idly by and permits intervening events to extinguish old rights and create new ones." *Mac Panel Co. v. Virginia Panel Corp.*, 283 F.3d 622, 625 (4th Cir. 2002). This reasoning does not apply when the Trustee brings an appeal on behalf of absent individuals. The Trustee does not occupy the normal status as a "party" attempting to create or enlarge its own rights. Rather, the

Trustee acts as a "watchdog" serving the role of "protecting the public interest and ensuring that bankruptcy cases are conducted according to law." In re Clark, 927 F.2d 793, 795 (4th Cir. 1991). As the Supreme Court has recognized, when the public interest rather than private rights are at stake, equitable doctrines take on a different role in favor of protecting the public interests. See Kansas v. Nebraska, 574 U.S. 445, 456, 135 S.Ct. 1042, 191 L.Ed.2d 1 (2015) ("As we have previously put the point: When federal law is at issue and 'the public interest is involved,' a federal court's 'equitable powers assume an even broader and more flexible character than when only a private controversy is at stake."); Off. of Pers. Mgmt., 496 U.S. at 419, 110 S.Ct. 2465 ("From our earliest cases, we have recognized that equitable estoppel will not lie against the Government as it lies against private litigants.").

Here, a finding of equitable mootness would preclude the Trustee from fulfilling its duty of protecting the public interest and preventing the abuse of the bankruptcy system. In fact, these facts demonstrate the need for the Trustee to discharge his statutory responsibilities. Not only did the parties craft a release that would extinguish the rights of countless individuals, they did so in a way that would insulate the release from judicial review. As the Securities Litigation Lead Plaintiffs' plight reveals, any party that challenges the Third-Party Releases loses standing to *698 challenge the Third-Party Releases. Indeed, Debtors have argued vehemently that the Securities Litigation Lead Plaintiffs lack standing to challenge the releases. Without the Trustee's ability to serve as a watchdog, the Court might not ever endeavor to conduct a merits-based review of the Third-Party Releases that discharge the claims of thousands of absent individuals. The Trustee must have the ability to speak for those parties affected by a bankruptcy proceeding when the other interested parties have been effectively silenced from speaking on behalf of themselves. Accordingly, the Court will not apply the doctrine of equitable mootness against the Trustee when the Trustee seeks to protect the rights of absent individuals.

[96] [97] Third, the seriousness of the Bankruptcy Court's errors counsels against a finding of equitable mootness. As the Eighth Circuit recently explained in response to the assertion of equitable mootness, "invoking this doctrine often results in the refusal of the Article III courts to entertain a live appeal over which they indisputably possess statutory jurisdiction and in which meaningful relief can be awarded. An Article III appellate court has a virtually unflagging obligation to exercise its subject matter jurisdiction." *In re VeroBlue Farms*

USA, Inc., 6 F.4th 880, 883 (8th Cir. 2021) (cleaned up). Here, the Bankruptcy Court extinguished the claims of absent and nonconsenting parties without the constitutional authority to adjudicate those claims. Pragmatism does not outweigh the need to remedy constitutional errors. See Stern, 564 U.S. at 501, 131 S.Ct. 2594 ("It goes without saying that the fact that a given law or procedure is efficient, convenient, and useful in facilitating functions of government, standing alone, will not save it if it is contrary to the Constitution.") (cleaned up). These constitutional errors directly concern the integrity of the bankruptcy process. "Equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process." In re Pac. Lumber Co., 584 F.3d at 251-53.

Fourth, the facts here do not suggest that "effective judicial relief is no longer practically available." In re Bate Land & Timber, LLC, 877 F.3d at 195. Debtors have offered no reason for the Court to conclude that it could not sever the Third-Party Releases here, and the Court has already found them severable. Such relief would not alter any creditor's recovery or affect the bankruptcy estate in any way. Id. Indeed, the overriding defect in the Third-Party Releases arises from the fact that it releases claims entirely attenuated from the Bankruptcy Case — claims that have no connection to the Bankruptcy Case against nondebtors held by third parties. Although Debtors point to the Nonseverability Provision, the Court does not believe that this provision constrains the ability to offer effective judicial relief. For one, without a valid Confirmation Order in place, the Nonseverability Provision now provides that the Court can sever the offending releases. In any event, a boilerplate nonseverability clause included by a debtor and other negotiating parties must not preclude appellate review of provisions that extinguish the rights of others in favor of those negotiating parties. In re Charter Commc'ns, Inc., 691 F.3d at 485 ("Allowing a boilerplate nonseverability clause, without more, to determine the equitable mootness question would give the debtor and other negotiating parties too much power to constrain Article III review.").

2. Application of the Equitable Mootness Factors

Turning to the factors, they do not support a finding of equitable mootness and the Court will decline to exercise its discretion *699 to avoid reviewing the merits of this appeal. See Behrmann, 663 F.3d at 711 ("[W]hether a court should

lend its aid in equity to a Chapter 11 debtor will turn on the particular facts and circumstances of the case")

First, Appellants sought a stay in the Bankruptcy Court and this Court but failed in both attempts. Although they failed to obtain a stay, they moved for one at both levels, so this differs from the case where a party makes a strategic choice that "allow[s] the reorganization plan to go into effect, taking the risks that attended such a decision." Mac Panel Co. v. Virginia Panel Corp., 283 F.3d 622, 625 (4th Cir. 2002) (moving for a stay in the bankruptcy court but choosing not to in the district court weighs in favor of a finding of equitable mootness). Moreover, the Trustee's requested relief does not seek to affect the recovery of any creditor; therefore, its unsuccessful attempts to obtain a stay would not render it inequitable for the Court to rule on the appeal. See In re Bate Land & Timber, LLC, 877 F.3d at 196 ("But because BLC merely seeks to add to its recovery from the Debtor's pocket without affecting the recovery of any other creditor, we conclude that BLC's unsuccessful attempt to obtain a stay would not render it inequitable for this court to provide the requested relief."). Additionally, this Court denied the request for a stay based on the high burden placed on a party requesting a stay. It expressly left open the door for Appellants to prevail on the merits. Closing that door now, simply because the Court did not previously grant a stay, would itself cause inequity.

[98] Second, the substantial consummation of the Plan does not render it inequitable to rule on this appeal. When "the relief requested does not seek to undo any aspect of the Confirmed Plan that has been consummated, it would not be impractical, imprudent, or inequitable to allow the appeal to proceed." *Id.* The Plan is no longer in the post-confirmation phase. Moreover, the Trustee does not seek to undo any transactions that have occurred in the Plan's undertaking. Indeed, the requested relief — invalidating all or parts of the releases at issue — would only prospectively affect the ability of parties to bring suits based on past events. It would require no unwinding.

Similarly, the third factor, the extent to which the relief requested would affect the success of the reorganization plan, counsels against a finding of equitable mootness. Invalidating or altering the releases would not impact the recovery of any creditors. Indeed, the Plan itself states that the Third-Party Releases can be severed. The Plan would not be disturbed in any material way by allowing third parties to retain their causes of action against non-debtors.

The fourth — and most important — factor concerns the effect on the interests of third parties. *In re VeroBlue Farms* USA, Inc., 6 F.4th at 889-90 (stressing that the most important factor in this analysis is the impact on third parties). As the releases here only apply to claims arising on or before the Effective Date, no post-confirmation transactions with third parties have occurred in reliance on the releases. Thus, considering the merits of the appeal would not negatively affect any third parties who relied on the confirmation of the Plan. See In re Bate Land & Timber, LLC, 877 F.3d at 196 ("The Debtor has not engaged in significant transactions with third parties who relied on the Confirmed Plan's terms such that alteration of the Confirmed Plan would negatively impact the Confirmed Plan and the third parties who relied upon it."). Conversely, extinguishing the claims of thousands of individuals without compensation, without consent and without due process *700 reeks of inequity to third parties. See In re Continental Airlines, 203 F.3d at 211 ("In balancing the policy favoring finality of bankruptcy court judgments — particularly reorganization plans — against other considerations, we note as well that the equities here would not dictate dismissal. Plaintiffs, who have never had their day in court, have been forced to forfeit their claims against non-debtors with no consideration in return.").

Finally, the doctrine of equitable mootness is all too often invoked to avoid judicial review, as Debtors seek to do here. *In re VeroBlue Farms USA, Inc.*, 6 F.4th at 889-91; *In re Charter Commc'ns, Inc.*, 691 F.3d at 485. That concern takes on greater import here with the shockingly broad releases and the inclusion in the Plan of an attempted "poison pill" Nonseverability Provision. The errors committed by the Bankruptcy Court here are serious and command review by an Article III court. That Debtors invoke an equitable principle designed to promote a fair outcome embodies the height of irony.

Consequently, the Court concludes that the equities strongly favor considering the merits of this appeal. Debtors' doomsday scenarios all stem from the inclusion of the Nonseverability Provision. However, the Court will not allow that provision or an equitable doctrine to preclude appellate review of plainly erroneous release provisions. Indeed, the Released Parties have given themselves broad releases and have sought to immunize the unconstitutional releases from appellate review with the inclusion of an inflexible Nonseverability Provision (which no longer has any effect). Equity does not support this.

G. The Exculpation Provision

The Trustee further argues that the Bankruptcy Court erred in approving the Exculpation Provision. (Trustee Br. at 43.) First, the Trustee submits that the Bankruptcy Court should have applied the *Behrmann* factors to the Exculpation Provision. (Trustee Br. at 43.) Second, the Trustee asserts that the Exculpation Provision bars claims against an overly broad set of parties and fails to include an exception for claims to proceed with court approval. (Trustee Br. at 44.) The Exculpation Provision provides:

[N]o Exculpated Party shall have or incur, and each Exculpated Party is hereby released and exculpated from any Cause of Action or any claim arising from the Petition Date through the Effective Date related to any act or omission in connection with, relating to or arising out of, the Chapter 11 Cases ... except for claims related to any act or omission that is determined in a Final Order to have constituted actual fraud, willful misconduct, or gross negligence.

[99] [100] [101] [102] party releases that offer protection to non-debtors for preconfirmation liability, an exculpation provision serves to protect court professionals who act reasonably while carrying out their responsibilities in connection with the bankruptcy case. Exculpation provisions do not release parties, but instead raise the liability standard of fiduciaries for their conduct during their case. In re Health Diagnostic Lab. Inc., 551 B.R. 218, 232 (Bankr. E.D. Va. 2016). Exculpation provisions "generally are permissible, so long as they are properly limited and not overly broad." In re Nat'l Heritage Found., Inc., 478 B.R. 216, 233 (Bankr. E.D. Va. 2012). To that end, courts will approve an exculpation provision "so long as it is limited to those parties who have served the debtor, is narrowly tailored and complies with the applicable standards." In re Alpha Nat. Res., Inc., 556 B.R. 249, 260 (Bankr. E.D. Va. 2016). "Exculpation is appropriate when it is solely limited to *701 fiduciaries who have served a debtor through a chapter 11 proceeding." In re Health Diagnostic Lab., Inc., 551 B.R. at 232-33.

[104] [105] Exculpation clauses have their genesis in two different sources: the *Barton* Rule and Section 1103(c) of the Bankruptcy Code. *In re Nat'l Heritage Found., Inc.*, 478 B.R. at 233. Under the *Barton* Rule, based on *Barton v. Barbour*, 104 U.S. 126, 26 L.Ed. 672 (1881), a party cannot bring a suit against a bankruptcy trustee or the trustee's attorneys for acts within the trustee's duties of recovering assets for the estate

without first obtaining leave of court. *McDaniel v. Blust*, 668 F.3d 153, 157 (4th Cir. 2012). "The Barton doctrine serves the principle that a bankruptcy trustee is an officer of the court that appoints him and therefore that court has a strong interest in protecting him from unjustified personal liability for acts taken within the scope of his official duties." *Id.* In *McDaniel*, the Fourth Circuit affirmed dismissal of claims against the trustee's counsel, because the plaintiff's allegations "can be considered by the bankruptcy court ... in its role as gatekeeper." *Id.* at 157.

[106] [107][108] Under Section 1103(c) of the Bankruptcy Code, the Creditors' Committee possesses broad authority to formulate a plan and perform "such other services as are in the interest of those represented." 11 U.S.C. § 1103(c). Courts have interpreted this section to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members. In re PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000). "This immunity covers committee members for actions within the scope of their duties." Id. "[A] proper exculpation provision is a protection [103] In contrast to thirdsupervised and court-approved transactions." In re Aegean Marine Petroleum Network, Inc., 599 B.R. at 721. Thus, a narrowly tailored exculpation provision serves only those aims of protecting parties who have performed necessary duties in connection with the case.

1. Behrmann and Exculpation Provisions

[109] The Trustee argues that the Bankruptcy Court erred in failing to apply the *Behrmann* factors to the Exculpation Provision. (Trustee Br. at 43.) However, he cites no case law in support of his argument. Further, the Fourth Circuit in *Behrmann* did not analyze the exculpation provision at issue; instead, the Court only mentioned it as being part of the plan.

Moreover, the purposes behind the *Behrmann* factors do not fully align with the purposes of an exculpation provision. As discussed above, the *Behrmann* factors seek to determine the necessity of a release to the ultimate success of a particular plan and the release's effect on the impacted classes. Exculpation provisions, on the other hand, serve to ensure that court-supervised parties can carry out transactions to effectuate the plan without fear of liability for court-authorized actions. Accordingly, the Court concludes that the Bankruptcy Court did not err by failing to apply the *Behrmann*

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

factors to the Exculpation Provision. However, that does not end the analysis of the Exculpation Provision.

2. The Bankruptcy Court's Error in Approving the Exculpation Provision

On remand from the Fourth Circuit, the bankruptcy court in the *Behrmann* case approved the exculpation provision there (but not the third-party release provision). *702 *In re National Heritage Found., Inc.*, 478 B.R. at 234. ¹⁴ Specifically, the bankruptcy court approved the exculpation provision because 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.

[110] *Id.* The Court finds these factors persuasive, with additional limitations found in the case law and the underpinnings of the bases for exculpation provisions. Therefore, an exculpation provision that "is limited to those parties who have served the debtor, is narrowly tailored and complies with the applicable standards," *In re Alpha Nat. Res., Inc.*, 556 B.R. at 260, must contain the following limitations:

- (a) it 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 pre-petition claims;
- (d) contains a carve out for gross negligence, actual fraud or willful misconduct; and,
- (e) contains a gatekeeper function.

An exculpation clause narrowly tailored to these factors serves the purposes underpinning exculpation provisions. Additionally, adhering to these limitations ensures that a court need not test the exculpation provision against the *Behrmann* factors. The further that an exculpation provision stretches beyond these limitations, the closer that it becomes in substance to a more general non-debtor release to which the *Behrmann* analysis must apply.

[111] Here, the Exculpation Provision satisfies some, but not all, of these limiting factors. In support of approval, it is limited to acts and omissions taken in connection with the bankruptcy case, does not release any pre-petition conduct and contains a carve out for gross negligence, actual fraud or willful misconduct. However, it extends beyond fiduciaries who have performed necessary and valuable duties. Instead, the "Exculpated Parties" include all current and former employees, attorneys, accountants, managers, financial advisors and consultants of every party being exculpated. Additionally, it lacks a gatekeeping function.

In conclusion, the Exculpation Provision extends beyond the permissible parties and fails to contain a gatekeeper function that would allow an avenue into court for some claims. Therefore, the Court concludes that the Bankruptcy Court clearly erred in approving the Exculpation Provisions. However, unlike the Third-Party Releases, the Court believes that this can be redrafted on remand to comply with the requirements outlined here.

IV. CONCLUSION

The Bankruptcy Court extinguished a broad swath of claims held by a wide variety of people. However, despite this drastic action, the Bankruptcy Court failed to determine whether it had the authority to rule on those claims or whether the *703 facts supported extinguishing those claims. Indeed, the Bankruptcy Court plainly lacked the constitutional power to adjudicate many of the claims encompassed by the Third-Party Releases and to confirm the Reorganization Plan. Therefore, the Court VACATES the Bankruptcy Court's Order (Bankr. Dkt. No. 1811; USTAPP 2530-2672) confirming Debtors' Reorganization Plan, VOIDS the Third-Party Releases and RENDERS the Third-Party Releases UNENFORCEABLE. The Court FINDS the voided Third-Party Releases to be SEVERABLE from the Reorganization Plan and, therefore, SEVERS the voided Third-Party Releases from Debtors' Reorganization Plan.

Additionally, the Court FINDS the Exculpation Provision to be overly broad and, therefore, VOIDS the Exculpation

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

Provision as currently drafted. However, the Court believes that the Exculpation Clause could be redrafted to comply with the applicable law in a manner consistent with this Opinion. Consequently, the Court hereby REMANDS this case to the Bankruptcy Court with instructions to redraft the Exculpation Provision in a manner consistent with this Opinion and then to proceed with confirmation of the Plan without the voided Third-Party Releases. ¹⁵

Finally, the Court FINDS that the interests of justice warrant reassigning this case to another Bankruptcy Judge in this district outside of the Richmond Division and therefore ORDERS the Chief Judge of the Bankruptcy Court for this district to REASSIGN this case on remand to another Bankruptcy Judge in this district outside of the Richmond Division. ¹⁶ The Chief Judge may reassign the case to himself if he believes the interests of justice so warrant. ¹⁷

Accordingly, this case will be remanded to the Bankruptcy Court in accordance with the instructions herein. An appropriate order shall issue.

The Clerk is directed to file this Memorandum Opinion electronically, notify all counsel of record and forward a copy to the chambers of Chief United States Bankruptcy Judge Frank J. Santoro and United States Bankruptcy Judge Kevin R. Huennekens.

It is so ORDERED.

All Citations

636 B.R. 641

Footnotes

- 1 The United States Securities and Exchange Commission (SEC) supported the Trustee's appeal as an amicus.
- The other appeals consolidated into this action are Case No. 3:21cv166 and Case No. 3:21cv205.
- 3 The Honorable Kevin R. Huennekens, United States Bankruptcy Judge for the Eastern District of Virginia (Richmond Division).
- To be clear, venue properly exists in the Richmond Division, as Debtors latched onto the existing bankruptcy of one of their affiliates, Dress Barn, which is incorporated in Virginia, as the basis for venue. 28 U.S.C. § 1408. Consequently, the question is not whether venue was proper here, but instead why Debtors chose this venue over the many other venue options that it had available to it. During oral argument, counsel for Debtors had no explanation for his client's choice of Richmond to file for bankruptcy. (Arg. Tr. at 78:20-22.)
- Unless otherwise cited, the Court takes these facts from the Bankruptcy Court's Opinion ("Bankr. Confirm. Op.") explaining its reasoning for confirming the Plan, found at pages USTAPP 2837-2876 of the Trustee's Appendix (("USTAPP") (ECF Nos. 35-1 through 35-3)). In citing pages contained in the Trustee's Appendix, the Court will cite to the page numbers following "UST" in the Trustee's Appendix.
- 6 Newman v. Ascena Retail Group, Inc., et al., 2:19cv13529 (D.N.J.).
- 7 The Securities Litigation Lead Plaintiff's other notice of appeal initiated Case No. 3:21cv166, which the Court then consolidated into this action.
- The Trustee's notice of appeal initiated Case No. 3:21cv205, which the Court then consolidated into this action.
- The Securities Litigation Lead Plaintiffs have raised additional issues in this appeal. Specifically, they claim that the Bankruptcy Court erred in finding that they lacked the authority to opt out on behalf of the putative class and in declining to certify the class for the limited purpose of opting out on behalf of the class. (Appellants' Br. at 82-85.) However, the Court's ultimate conclusion that the Third-Party Releases are unenforceable renders moot the question of whether the Bankruptcy Court should have provided some mechanism to opt out of the class from the Third-Party Releases.

Patterson v. Mahwah Bergen Retail Group, Inc., 636 B.R. 641 (2022)

- 10 As the Bankruptcy Court made no attempt to discern whether the Releasing Parties consented to it adjudicating their non-core claims, the Court must assume that it would have relied on the same manner of consent that it relied on in finding that the Releasing Parties consented to the Third-Party Releases.
- 11 Notably, the evidence was uncontroverted; therefore, there is no need to assess the credibility of the witnesses.
- 12 Indeed, in a footnote, the court acknowledged the appellees' argument that a bankruptcy court could always constitutionally confirm a plan. However, it stated that "[w]e have our doubts about so broad a statement but we do not need to address it to decide this case." *Id.* at 137, n.10.
- Likewise, Gary Begeman refused to testify when asked whether the confirmation could proceed absent the Third-Party Releases. (Confirm. Tr. at 47:18-21.)
- 14 The parties thereafter did not appeal the approval of the exculpation provision.
- The Court notes that the Exculpation Provision does not implicate *Stern* issues, so the Bankruptcy Court possesses the constitutional authority to confirm Debtors' Reorganization Plan without the voided Third-Party Releases. Additionally, no party objects to any other aspect of the Plan than addressed here.
- The Court has considered the factors for reassignment as set forth in *United States v. McCall*, 934 F.3d 380, 384 (4th Cir. 2019), and believes that reassignment is warranted here due to the practice of issuing third-party releases in the Richmond Division in contravention of the Fourth Circuit's admonitions in *Behrmann*. To be clear, the undersigned does not question the integrity or impartiality of Judge Huennekens. Indeed, the contrary is true, as the undersigned holds Judge Huennekens in high regard. However, the practice of regularly approving third-party releases and the related concerns about forum shopping call into question public confidence in the manner that these cases are being handled by the Bankruptcy Court in the Richmond Division.
- Even though the case shall be reassigned to a Bankruptcy Judge outside of the Richmond Division, the case shall remain a Richmond Division case and any appeal after remand shall be assigned to the undersigned.

End of Document

© 2022 Thomson Reuters. No claim to original U.S.
Government Works.

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

KeyCite Yellow Flag - Negative Treatment
Declined to Follow by In re Purdue Pharma, L.P., S.D.N.Y., December 16, 2021

780 F.3d 1070 United States Court of Appeals, Eleventh Circuit.

In re SEASIDE ENGINEERING & SURVEYING, INC., Debtor. SE Property Holdings, LLC, Claimant–Appellant,

Seaside Engineering & Surveying, Inc., Defendant–Appellee.

> No. 14–11590. | | March 12, 2015.

Synopsis

Background: Chapter 11 debtor, a closely held civil engineering and surveying firm that conducted forms of technical mapping, sought confirmation of second amended plan of reorganization. Outside equity holder in debtor objected. The United States Bankruptcy Court for the Northern District of Florida approved the plan, and equity holder appealed. The District Court, No. 3:12–cv–511–MW/EMT, Mark E. Walker, J., 2014 WL 1303707, affirmed. Equity holder appealed.

Holdings: The Court of Appeals, Anderson, Circuit Judge, held that:

- [1] the bankruptcy court committed no error in valuing debtor as it did, under a going-concern analysis and taking into consideration the risk of losing key employees;
- [2] bankruptcy courts have authority to approve nonconsensual non-debtor releases or bar orders in bankruptcy restructuring plans, though such releases or orders should not be issued lightly;
- [3] the bankruptcy court did not abuse its discretion in applying the *Dow Corning* factors and approving the non-debtor releases contained in debtor's plan;

- [4] debtor did not propose its plan in bad faith;
- [5] equity holder was not the subject of unfair discrimination, even though other stockholders of debtor received stock in the reorganized entity and it did not; and
- [6] the bankruptcy court did not clearly err with respect to the interest rate payable on equity holder's promissory notes.

Affirmed.

West Headnotes (25)

[1] Bankruptey Conclusions of law; de novo review

Bankruptcy 🧽 Particular cases and issues

Bankruptcy court's valuation of a debtor is a mixed question of law and fact; the selection of a valuation method is a legal matter subject to de novo review, while findings made under that standard are facts subject to clear error review.

1 Cases that cite this headnote

[2] Bankruptcy 🧽 Valuation

In valuing Chapter 11 debtor, a civil engineering and surveying firm, bankruptcy court committed no error in using a going-concern analysis and, in selecting a discount rate, in taking into consideration the risk of losing key employees; although entity that objected to confirmation of debtor's proposed plan asserted that the court had used a forced-sale method, the court in fact did not, as it explicitly stated the correct method of valuation was to value debtor as a going concern, the court considered future losses, which are necessary to a discounted cash-flow analysis, the core of a going-concern valuation, and the court discussed and selected a discount rate, the critical input to calculate the present value of a business based on a cash flow, and given debtor's business, which relied upon human expertise and established relationships with clients, risk of losing key employees was a relevant factor.

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

1 Cases that cite this headnote

[3] Bankruptcy 🧽 Valuation

All relevant factors to property value must be considered by the bankruptcy court to arrive at a just valuation of a property for Chapter 11 plan purposes.

1 Cases that cite this headnote

[4] Bankruptcy 🧽 Confirmation; Objections

In its valuation of a debtor, the bankruptcy court has discretion to weigh expert testimony and select portions to accept or reject.

[5] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy courts have authority to approve non-consensual non-debtor releases or bar orders in bankruptcy restructuring plans, though such releases or orders ought not to be issued lightly, and should be reserved for those unusual cases in which they are necessary for the success of the reorganization, and only in situations in which they are fair and equitable under all the facts and circumstances.

7 Cases that cite this headnote

[6] Bankruptcy Equitable powers and principles

Bankruptcy courts apply the principles and rules of equity jurisprudence. 11 U.S.C.A. § 105(a).

1 Cases that cite this headnote

[7] **Bankruptcy** Settlement, adjustment, or enforcement of claims

In determining whether to approve a non-debtor release or bar order contained in a proposed plan, the bankruptcy court's inquiry is fact-intensive in the extreme.

2 Cases that cite this headnote

[8] Bankruptcy Settlement, adjustment, or enforcement of claims

Pursuant to the Sixth Circuit's Dow Corning test, bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor if: (1) there is an identity of interests between debtor and third party, usually an indemnity relationship, such that suit against non-debtor is, in essence, suit against debtor, or will deplete assets of the estate, (2) non-debtor has contributed substantial assets to the reorganization, (3) injunction is essential to reorganization, namely, reorganization hinges on debtor being free from indirect suits against parties who would have indemnity or contribution claims against it, (4) impacted class, or classes, has overwhelmingly voted to accept the plan, (5) plan provides mechanism to pay for all, or substantially all, of the class or classes affected by the injunction, (6) plan provides opportunity for those claimants who choose not to settle to recover in full, and (7) court made a record of specific factual findings that support its conclusions.

11 Cases that cite this headnote

[9] Bankruptcy Settlement, adjustment, or enforcement of claims

In determining whether to approve a non-debtor release or bar order contained in a proposed plan, the bankruptcy court should have discretion to decide which of the *Dow Corning* factors will be relevant in each case.

3 Cases that cite this headnote

[10] Bankruptcy - Settlement, adjustment, or enforcement of claims

Seven *Dow Corning* factors should be considered a nonexclusive list of considerations in determining whether to approve a nondebtor release or bar order, and should be applied flexibly, always keeping in mind that such bar orders should be used cautiously and infrequently, and only where essential, fair, and equitable.

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

4 Cases that cite this headnote

[11] Bankruptcy 🕪 Discretion

Court of Appeals reviews a bankruptcy court's approval of non-debtor releases for abuse of discretion.

6 Cases that cite this headnote

[12] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy 🧽 Confirmation; Objections

In approving proposed plan of reorganization of Chapter 11 debtor, a closely held civil engineering and surveying firm, bankruptcy court did not abuse its discretion in applying Dow Corning factors and approving plan's non-debtor releases, which prevented claims against non-debtors that would undermine operations of, and doom possibility of success for, the reorganized entity; releases included former principals of debtor who would be key employees of reorganized entity, whose business was completely dependent upon the skilled labor of the releasees, who would be defendants in any further litigation, releases were essential to reorganization, equity holders rejecting plan would be paid full value of their interests, bankruptcy court made thorough factual findings, and releases were fair and equitable, and narrowly limited in scope to claims arising out of the Chapter 11 case.

5 Cases that cite this headnote

[13] Bankruptcy Scope of review in general Bankruptcy Particular cases and issues

In reviewing the bankruptcy court's determination that debtor's Chapter 11 plan was not proposed in bad faith, the Court of Appeals gives deference to all findings of fact if based upon substantial evidence, but freely examines the applicable principles of law to see if they were properly applied and freely examines the evidence in support of any particular finding to see if it meets the test of substantiality. 11 U.S.C.A. § 1129(a)(3).

[14] Bankruptcy 🧽 Good faith and legality

While the Bankruptcy Code does not define the term, courts have interpreted the "good faith" requirement for confirmation of a Chapter 11 plan as requiring that there is a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Code. 11 U.S.C.A. § 1129(a)(3).

[15] Bankruptcy 🧽 Good faith and legality

In the context of determining whether a Chapter 11 plan has been proposed in good faith, the purposes of the Bankruptcy Code include preserving jobs in the community, allowing the business to continue to operate instead of liquidation, and achieving a consensual resolution between debtors and creditors. 11 U.S.C.A. § 1129(a)(3).

[16] Bankruptcy 🧽 Good faith and legality

In the context of determining whether a Chapter 11 plan has been proposed in good faith, "bad faith" exists if there is no realistic possibility of reorganization and the debtor seeks merely to delay or frustrate efforts of secured creditors. 11 U.S.C.A. § 1129(a)(3).

[17] Bankruptcy — Good faith and legality Bankruptcy — Unsecured creditors and equity holders, protection of

Chapter 11 debtor, a closely held civil engineering and surveying firm, did not propose its plan of reorganization in bad faith; plan was not, as objecting equity holder contended, intended for the sole and exclusive benefit of debtor's insiders, but benefited others as well, as debtor's non-shareholder employees would maintain their jobs, other creditors would receive compensation over time, and debtor's clients, including the Corps of Engineers, would continue to receive engineering services, and debtor's desire to reorganize without equity

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

holder as a shareholder was not part of some nefarious plot, but was justified by the fact that with equity holder as a shareholder, debtor risked losing its small-business status and, with it, a vital credit line. 11 U.S.C.A. § 1129(a)(3).

[18] Bankruptcy 🧽 Good faith and legality

Simply because one creditor is dissatisfied with a proposed Chapter 11 plan is insufficient to show bad faith. 11 U.S.C.A. § 1129(a)(3).

[19] Bankruptcy Unsecured creditors and equity holders, protection of

Proposed plan of reorganization of Chapter 11 debtor, a closely held civil engineering and surveying firm, did not unfairly discriminate against objecting equity holder, even though other stockholders of debtor received stock in the reorganized entity and it did not, where equity holder received full value for its stock interest. 11 U.S.C.A. § 1129(b)(2)(C)(i).

[20] Bankruptcy 🧽 Particular cases and issues

Court of Appeals reviews for clear error the adequacy of the interest rate contained in a confirmed Chapter 11 plan.

[21] Interest 🧽 Computation of rate in general

Taking its cue from ordinary lending practices, the Supreme Court's *Till* approach for determining the interest rate payable to creditors in bankruptcy proceedings begins by looking to the national prime rate, and, because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly.

1 Cases that cite this headnote

[22] Interest 🧽 Computation of rate in general

In confirming proposed plan of reorganization, the bankruptcy court did not clearly err with

respect to the interest rate payable on equity holder's promissory notes; the court applied the Supreme Court's *Till* formula, adding a 1% adjustment to the prime rate of 3.25%, and this 1% adjustment was within the range suggested by the Supreme Court.

2 Cases that cite this headnote

[23] Bankruptcy 🕪 Examination and Discovery

Bankruptcy court did not abuse its discretion by allowing Chapter 11 debtor to take Rule 2004 exams of objecting equity holder's officers; a broad inquiry was necessary to establish, for example, that equity holder's policies could result in continued litigation, thus bolstering the case for the proposed plan's non-debtor releases.

[24] Bankruptcy 🧽 Examination and Discovery

Bankruptcy court has wide discretion with respect to such discovery matters as the taking of Rule 2004 exams.

1 Cases that cite this headnote

[25] Eminent Domain Contracts in general; creditors' rights

Extinguishing of a property interest through bankruptcy proceedings, even if the creditor receives nothing, does not constitute a "taking" in violation of the Fifth Amendment. U.S.C.A. Const. Amend. 5.

Attorneys and Law Firms

*1074 Richard M. Gaal, McDowell Knight Roedder & Sledge, LLC, Mobile, AL, Theodore R. Howell, Barron & Redding, PA, Panama City, FL, for Claimant–Appellant.

Natasha Revell, Teresa Marie Dorr, Kenneth W. Revell, Zalkin Revell, PLLC, Santa Rosa Beach, FL, for Defendant—Appellee.

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

Appeal from the United States District Court for the Northern District of Florida. D.C. Docket Nos. 3:12–cv–00511–MW–EMT; 11–bkc–31637–WSS.

Before MARTIN and ANDERSON, Circuit Judges, and COTE, * District Judge.

Opinion

ANDERSON, Circuit Judge:

SE Property Holdings, LLC, and affiliated entity Vision–Park Properties, LLC, (collectively "Vision") appeal the district court's order upholding decisions in the bankruptcy restructuring proceedings of Seaside Engineering and Surveying, LLC ("Seaside" or "Debtor"). After careful review of the record, and with the benefit of oral argument, we affirm. In doing so, we provide guidance to the Circuit's bankruptcy courts with respect to a significant issue: i.e., the authority of bankruptcy courts to issue non-consensual, non-debtor releases or bar orders, and the circumstances under which such bar orders might be appropriate.

I. BACKGROUND

Seaside is a civil engineering and surveying firm that conducts forms of technical mapping. Seaside provided services to, among other clients, the U.S. Army Corps of Engineers. Seaside's principal shareholders prior to all bankruptcy litigation were John Gustin, James Mainor, Ross Binkley, James Barton, and Timothy Spears. The principals branched out from their work as engineers and entered the real estate development business, forming Inlet Heights, LLC, and Costa Carina, LLC. These wholly separate entities borrowed money from Vision with personal guaranties from the principals. Inlet Heights and Costa Carina defaulted on the loans, and Vision filed suit to recover amounts under the guaranties.

Gustin filed for Chapter 7 bankruptcy protection for himself. Mainor and Binkley followed suit. All were appointed Chapter 7 trustees. Gustin, Mainor, and Binkley listed their Seaside stock as non-exempt personal property in their required filings. In April 2011, the Chapter 7 trustee in the Gustin case conducted an action to sell Gustin's shares of Seaside stock. Gustin bid \$95,500.00, and Vision defeated the bid with a purchase price of *1075 \$100,000.00. Seaside attempted to block sale of Gustin's stock to Vision, but

the bankruptcy court confirmed the sale. Following the sale of Gustin's stock, Seaside filed for Chapter 11 bankruptcy protection on October 7, 2011. ¹

Seaside proposed to reorganize and continue operations as the entity Gulf Atlantic, LLC ("Gulf"), an entity managed by Gustin, Mainor, Binkley, and Bowden, and owned by four members, the respective irrevocable family trust of each manager. The outside equity holders would receive promissory notes with interest accruing at a rate of 4.25% in exchange for their interest in Seaside and thus be excluded from ownership in Gulf. The bankruptcy court approved the Second Amended Plan of Reorganization ("Second Amended Plan") or "Reorganization Plan"), over objection of Vision, valuing Seaside at \$200,000.00. The district court affirmed the bankruptcy court.

II. DISCUSSION

Vision raises myriad issues on appeal. The arguments all essentially reduce to Vision's objections to the bankruptcy court's valuation and to the composition of the reorganized entity under the Second Amended Plan of Reorganization. We address each argument in turn.

A. Valuation of Seaside

[1] Vision argues that the bankruptcy court improperly valued Seaside under a forced-sale analysis as opposed to a going-concern analysis. Vision continues that even under a forced-sale analysis, the bankruptcy court selected an inadequate discount rate by considering impermissible factors—particularly the risk of critical employees leaving the firm—and inadmissible expert testimony. The valuation of Seaside is a mixed question of law and fact. *In re Ebbler Furniture & Appliances, Inc.*, 804 F.2d 87, 89 (7th Cir.1986). Selection of a valuation method is a legal matter subject to *de novo* review, and findings made under that standard are facts subject to clear error review. *Id.*

[2] We disagree with Vision that the bankruptcy court valued Seaside using a forced-sale method. To begin, the bankruptcy court explicitly stated that "the correct method of valuation of the [D]ebtor is that as a going concern." The bankruptcy court also considered future losses, which are necessary to a discounted cash flow analysis, the core of a going-concern valuation. Most telling, the bankruptcy court discussed and

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

selected a discount rate, the critical input to calculate the present value of a business based on a cash flow.

[4] Having established use of the proper valuation method, the bankruptcy court committed no error in considering the risk of losing key employees in selecting a discount rate. "[A]ll relevant factors to property value must be considered to arrive at a just valuation of a property." In re Webb MTN, LLC, 420 B.R. 418, 435 (Bankr.E.D.Tenn.2009). Seaside's civil engineering and mapping operations rely upon human expertise, and its client base relies upon established relationships. The loss of key employees could equate to a complete deterioration of Seaside's value. Employee retention is certainly a relevant risk if not the key risk in calculating the discount rate in a case like this. The bankruptcy court also has discretion to weigh expert testimony and select portions to accept or reject. Id. Vision's argument *1076 is that the bankruptcy court did just this, and therefore the argument is unavailing. To reiterate, the bankruptcy court committed no error in valuing Seaside.

B. The Non-debtor Release or Bar Order ²

[5] As part of the Reorganization Plan, the bankruptcy court approved releases of claims against non-debtors:

[N]one of the Debtor, ... Reorganized Debtor, Gulf Atlantic ... (and any officer or directors or members of the aforementioned [entities]) and any of their respective Representatives (the "Releasees") shall have or incur any liability to any Holder of a Claim against or Interest in Debtor, or any other party-in-interest ... for any act, omission, transaction or other occurrence in connection with, relating to, or arising out of the Chapter 11 Case, the pursuit of confirmation of the Amended Plan as modified by the Technical Amendment, or the consummation of the Amended Plan as modified by this Technical Amendment, except and solely to the extent such liability is based on fraud, gross negligence or willful misconduct.

Reorganization Plan Art. IX.C. The district court upheld the propriety of these non-debtor releases. Although this Circuit has considered the propriety of such a release by a bankruptcy court, it has not done so recently. The issue warrants significant discussion.

1. History of Non-Debtor Releases in the Eleventh Circuit This Circuit has spoken at least once on the validity of non-debtor releases in bankruptcy restructuring plans. We approved a release of claims against a non-debtor in *In re*

Munford, 97 F.3d 449 (11th Cir. 1996). There, the debtor sued several defendants alleging breach of fiduciary duties related to a leveraged buy out. Id. at 452. One defendant offered to settle the claims but denied liability and conditioned its offer of settlement on issuance by the bankruptcy court of a protective order enjoining the non-settling defendants from pursuing contribution or indemnity claims against the settling defendant. Id. In order to make the settlement possible and to fund the bankruptcy estate, the bankruptcy court issued a protective order barring the non-settling defendants from seeking contribution or indemnification from the settling defendant. Id. We held that 11 U.S.C. § 105(a)³ gives bankruptcy courts authority to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code, including the bar order in that case. We upheld the non-debtor release because the settling defendant "would not have entered into the settlement agreement" without the bar order and because the bar order was "integral to settlement in an adversary proceeding." Munford, 97 F.3d at 455.

Munford is the controlling case here, indicating that this Circuit permits non- *1077 debtor releases at least under some circumstances. However, the facts of this case differ from those considered in Munford. Instead of the settlement context in Munford, here the releases prevent claims against non-debtors that would undermine the operations of, and doom the possibility of success for, the reorganized entity, Gulf. Other Circuits have addressed substantively similar releases, which we now consider.

2. Non-debtor Releases in Sister Circuits

Other circuits are split as to whether a bankruptcy court has the authority to issue a non-debtor release and enjoin a nonconsenting party who has participated fully in the bankruptcy proceedings but who has objected to the non-debtor release barring it from making claims against the non-debtor that would undermine the operations of the reorganized entity. Collier Bankruptcy Practice Guide 5 reports the circuit split as follows. The authors indicate, as the minority view, that the Ninth and Tenth Circuits prohibit such bar orders. Our research reveals that the Fifth Circuit is also in the minority with respect to this issue. In In re Vitro S.A.B. DE C.V., 701 F.3d 1031, 1061 (2012), the Fifth Circuit interpreted its prior precedent, saying that it "seem[s] broadly to foreclose nonconsensual non-debtor releases in permanent injunctions." The opinions for these minority circuits base their conclusion on 11 U.S.C. § 524(e), which provides *1078 in relevant

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

part: "[D]ischarge 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." *Collier* cites the majority of the circuits as holding that such releases/injunctions are permissible, under certain circumstances, reporting the Second, Third, Fourth, Sixth, and Seventh Circuits as so holding, 7 and the First, Eleventh, and D.C. Circuits as indicating that they agree with the "pro-release" circuits. 8

3. Eleventh Circuit Law is Consistent with the Majority View

As indicated in Part II.B.1 above, we believe that our Munford case places this Circuit within the majority rule on this issue. As noted above, in *Munford*, we held that § 105(a) provided authority for the bankruptcy court to enter the bar order in that case, where the settling defendant provided funds for the bankruptcy estate, but would not have entered into the settlement in the absence of such bar order, and where the bankruptcy court found that the bar order was fair and equitable. In particular, we respectfully disagree with the position of the minority circuits with respect to § 524(e). As noted, that section, in relevant part, provides that the "discharge of a debt of the debtor does not affect the liability of another entity on ... such debt." We agree with the Seventh Circuit in Airadigm: "The natural reading of this provision does not foreclose a third-party release from a creditor's claims." 519 F.3d 640, 656 (2008). Pursuant to § 524(e), the discharge of the debtor's debt does not itself affect the liability of a third party, but § 524(e) says nothing about the authority of the bankruptcy court to release a non-debtor from a creditor's claims. As the Airadigm court noted, if Congress had meant to limit the powers of bankruptcy courts, it would have done so clearly, as it did in other instances, or it would have done so by creating requirements for plan confirmation as in 11 U.S.C. § 1129(a) ("The court shall confirm a plan only if the following requirements are met....").

[6] [7] Consistent with the majority view, we agree that § 105(a) codifies the established law that a bankruptcy court "applies the principles and rules of equity jurisprudence." *Airadigm*, 519 F.3d at 657 (quoting *Pepper v. Litton*, 308 U.S. 295, 304, 60 S.Ct. 238, 244, 84 L.Ed. 281 (1939)). We also agree, however, with the majority view that such bar orders ought not to be issued lightly, and should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts

and circumstances. *1079 The inquiry is fact intensive in the extreme

[8] [9] [10] Like the Fourth Circuit in *Behrmann v. National Heritage Foundation*, 663 F.3d 704, 712 (2011), we commend for the consideration of bankruptcy courts the factors set forth by the Sixth Circuit in *Dow Corning Corp.*, 280 F.3d at 658. There, the Sixth Circuit established a seven-factor test to guide bankruptcy courts, as follows:

[W]hen the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor: (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to 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; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions.

Id. Again, we agree with the Fourth Circuit in *Behrmann* that bankruptcy courts should have discretion to determine which of the *Dow Corning* factors will be relevant in each case. 663 F.3d at 712. The factors should be considered a nonexclusive list of considerations, and should be applied flexibly, always keeping in mind that such bar orders should be used "cautiously and infrequently," *id.* at 712, and only where essential, fair, and equitable. *Munford*, 97 F.3d at 455.

Having set forth the foregoing standard, we turn next to review the bankruptcy court's application of the *Dow Corning* factors.

4. Application of the *Dow Corning* Factors

[11] [12] Recognizing the existing split among the circuits as to whether a third-party release is permissible for non-debtors, but then relying on decisions of other Florida bankruptcy courts, the bankruptcy court applied the *Dow Corning* factors in a manner consistent with this opinion. We review a bankruptcy court's approval of non-debtor releases

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

for abuse of discretion. In re Munford, 97 F.3d 449, 456 (11th Cir.1996). Vision argues that this release satisfies none of the Dow Corning factors. We disagree.

a. Factor One: An identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate.

The bankruptcy court concluded that this factor favored Seaside and favored inclusion in the Reorganization Plan of the non-debtor release. The bankruptcy court concluded that Gulf would deplete its assets continuing to defend against the voluminous litigation. The releasees in this case include Gustin, Mainor, Binkley, Bowden, and other former principals of Seaside who will be the key employees of the reorganized entity, Gulf. The reorganized entity's business is completely dependent upon the skilled labor of the releasees, its professional surveyors and engineers, as was the former business of the Debtor. *1080 These releasees would also be defendants in any further litigation and, in the absence of the bar order, would expend their time in defense of litigation as opposed to focusing on their professional duties for the reorganized entity. Applying this first factor flexibly,⁹ we agree with the bankruptcy court that this factor favors approving the non-debtor release. Time equates to money for the engineers. The principals' preoccupation with additional lawsuits will interrupt the labor-intensive surveying, leading to a deterioration of the estate as Gulf loses valuable relationship-based work contracts.

b. Factor Two: The non-debtor has contributed substantial assets to the reorganization.

The bankruptcy court stated that "[n]one of the releases [sic] contributed any new value to the reorganized debtor other than the contribution of their labor." As other findings of the bankruptcy court make clear, the contribution of their services to the reorganized entity is the very "life blood of the reorganized debtor." Doc. 474-1 at 47-48 (emphasis in original). We conclude that this factor too favors Seaside.

c. Factor Three: The injunction is essential to 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 bankruptcy court noted the close relationship between the first factor and this factor. The bankruptcy court found that the bar order was absolutely essential. It found: "To say that this case has been highly litigious would be an understatement." Doc. 474-1 at 46. It found: "Without [the bar order] it would be doubtful that the engineers and surveyors would ever be able to perform their professional work, complete contracts and create receivables necessary for the life blood of the reorganized debtor." Id. at 47–48. The court also found that the time and efforts expended by Vision "would appear disproportionate to the value of Vision's equity interest." Id. at 48. We agree that, without the bar order, the litigation would likely continue, bleeding Gulf dry and dashing any hope for a successful reorganization. We conclude that this factor weighs heavily in favor of inclusion of the non-debtor release.

d. Factor Four: The impacted class, or classes, has overwhelmingly voted to accept the plan.

The bankruptcy court noted that Vision did reject this plan, as did two of the bankruptcy trustees (for Mainor and Binkley). However, the bankruptcy court noted that all other classes of creditors, whether impaired or not, have unanimously accepted the Reorganization Plan. Significantly, the court found that the equity holders rejecting the Plan will be paid the full value of their interests under the Plan. We cannot conclude that this factor favors Vision.

e. Factor Five: The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction.

The bankruptcy court again noted that Vision will be paid in full for its share of *1081 Seaside. This factor weighs heavily in favor of the releases.

f. Factor Six: The plan provides an opportunity for those claimants who choose not to settle to recover in full.

The bankruptcy court stated that this factor was inapplicable. We cannot conclude that the bankruptcy court abused its discretion in this regard. Other than its claims for payment for the full value of its equity interest in the Debtor-which

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

of course is to be paid in full under the Plan—Vision's identification of any other claims is vague. To the extent we can identify such other claims that Vision may be asserting, we conclude that they were made by Vision in challenging the Reorganization Plan and were rejected.

g. Factor Seven: The bankruptcy court made a record of specific factual findings that support its conclusions.

The bankruptcy court made *thorough* factual findings in reaching its decision. Its findings are amply supported by the evidence. The bankruptcy court's extensive consideration of this case weighs heavily against any abuse of discretion.

5. Additional Considerations Pursuant to Munford Whether or not the bankruptcy court had specifically in mind the "fair and equitable" requirement of Munford, 97 F.3d at 455, it went on to further discuss considerations relevant to such a finding. The bankruptcy court referred to this case as a "death struggle" and recognized the apparently disproportionate expenditure of time for what Vision claimed to be a company valued at \$960,000.00. Also very telling of the fairness and equity of the releases is that the bankruptcy court required the Debtor to voluntarily cease litigation of its claims for sanctions against Vision. This requirement prevented an asymmetrical benefit for Seaside from the Reorganization Plan. Finally, the release itself is narrowly limited in scope to claims arising out of the Chapter 11 case 10 and does not include claims arising out of fraud, gross negligence, or willful misconduct. See Airadigm, 519 F.3d at 657 (the Seventh Circuit viewed a very similar bar order as "narrow: it applies only to claims 'arising out of or in connection with' the reorganization itself and does not include 'willful misconduct.' ... This is not 'blanket immunity.' ").

6. Summary

We conclude that the bankruptcy court did not abuse its discretion in approving the non-debtor releases. The releases are fair and equitable, and wholly necessary to ensure that Gulf may continue to operate as an entity. This case has been a death struggle, and the non-debtor releases are a valid tool to halt the fight.

C. Bad Faith

Vision argues that Seaside proposed the Reorganization Plan in bad faith in contravention of the good faith requirement of 11 U.S.C. § 1129(a)(3). Vision characterizes the plan as intended "for the sole and exclusive benefit of its insiders." *In re Davis Heritage GP Holdings, LLC*, 443 B.R. 448, 461 (Bankr.N.D.Fla.2011).

*1082 [13] The parties dispute the proper standard of review of the bad faith determination. Vision argues that the bankruptcy court refused to follow the law and allowed outside factors to influence its decision, so this is an issue of law to be reviewed de novo, citing In re Fielder, 799 F.2d 656, 657 (11th Cir.1986). Seaside argues that this is an attempt to convert the standard of review and that controlling precedent requires this Court to use the clearly erroneous standard in reviewing the totality of the circumstances. When read in context, Fielder is clear. "This court as an appellate court gives deference to all findings of fact by the fact finder if based upon substantial evidence, but freely examines the applicable principles of law to see if they were properly applied and freely examines the evidence in support of any particular finding to see if it meets the test of substantiality." Id.

[14] [15] [16] "While the Bankruptcy Code does not define the term, courts have interpreted 'good faith' as requiring that there is a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Code." *In re McCormick*, 49 F.3d 1524, 1526 (11th Cir.1995). Those purposes include preserving jobs in the community, allowing the business to continue to operate instead of liquidation, and achieving a consensual resolution between debtors and creditors. *In re United Marine, Inc.*, 197 B.R. 942, 947 (Bankr.S.D.Fla.1996). "Bad faith exists if there is no realistic possibility of reorganization and the debtor seeks merely to delay or frustrate efforts of secured creditors." *Id.* (citing *In re Albany Partners, Ltd.*, 749 F.2d 670, 674 (11th Cir.1984)).

[17] [18] The Reorganization Plan benefits more than just the Seaside insiders. Seaside's non-shareholder employees will maintain their jobs; other creditors will receive compensation over time; and the Corps of Engineers will continue to receive engineering services. The Plan falls well within the purposes of the Bankruptcy Code and is therefore proposed in good faith. Simply because one creditor is dissatisfied is insufficient to show bad faith. Furthermore, with Vision as a shareholder, Seaside risked losing its small-business status, which would have eliminated a vital credit line, thus completely dooming the company. This consideration justifies Seaside's desire to reorganize Gulf

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

without Vision as a shareholder. See In re Texaco Inc., 84 B.R. 893, 907 (Bankr.S.D.N.Y.1988) (concluding a plan that enables to bring current, and resume future payments on, obligations signals good faith). The plan to remove Vision from control is not just some nefarious plot. Moreover, the record indicates that the key employees of the business would not continue to serve—the very life blood of the business—if Vision had a substantial role in the reorganized entity.

D. Fairness, Equity, and Discrimination in the Reorganization Plan

Relying upon both 11 U.S.C. § 1123(a)(4) ("A plan shall—... (4) provide the same treatment for each claim or interest of a particular class") and 11 U.S.C. § 1129(b) (1) (a provision commonly known as the "cram down" provision), Vision argues that the Plan of Reorganization was unfair and inequitable in that it discriminated against Vision as a stockholder of the Debtor, in comparison to other stockholders of the Debtor. First, Vision argues that the Plan violated § 1129(b)(2)(C)(i) (providing that each equity interest holder must receive the full value of its interest). The gist of this argument is that the bankruptcy court undervalued the equity interests, and therefore Vision did not receive full value for its *1083 stock. This argument merges with Vision's valuation objection, which we disposed of earlier in this opinion.

[19] Vision also argues that the Plan was discriminatory in that other stockholders of the Debtor received stock in the reorganized entity, while it did not. The bankruptcy court held that Vision received full value for its stock interest, and therefore § 1129(b)(2)(C)(i) was satisfied, and thus there was no discrimination. Thus, the bankruptcy court concluded that there was no unfair discrimination. Especially in the unusual circumstances of the instant case, we agree. Our research has uncovered no cases in which an objecting holder of an equity interest—who has been paid in full for the value of his interest—could prohibit a successful reorganization by insisting on becoming a stockholder in the reorganized entity. In none of the cases cited by Vision was an objecting equity holder paid the full value of its equity interest under the provisions of the Reorganization Plan.

E. Interest Rate on Promissory Notes Exchanged Pursuant to the Second Amended Restructuring Plan

[20] Vision did not receive an immediate cash payment for its interest in Seaside; rather, Vision received promissory notes accruing with an interest rate of 4.25%. Vision argues

that this rate does not adequately compensate for the highly prospective nature of the notes. This Court reviews the adequacy of the interest rate for clear error. *In re Brice Rd. Devs.*, 392 B.R. 274, 280 (6th Cir. BAP 2008).

[21] [22] The Supreme Court adopted the formula approach for determining the interest rate payable to creditors in bankruptcy proceedings. Till v. SCS Credit Corp., 541 U.S. 465, 478-79, 124 S.Ct. 1951, 1961, 158 L.Ed.2d 787 (2004). "Taking its cue from ordinary lending practices, the approach begins by looking to the national prime rate.... Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly." Id. Here, the bankruptcy court applied this formula, adding a 1% adjustment to the prime rate of 3.25%. The 1% adjustment is within the range suggested by the Supreme Court in Till, 124 S.Ct. at 1962, and therefore the bankruptcy court committed no clear error.

F. Exams Pursuant to Bankruptcy Rule 2004

[23] [24] Vision contends that the bankruptcy court abused its discretion by allowing Seaside to take Bankruptcy Rule 2004 exams of Vision officers. See In re Piper Aircraft Corp., 362 F.3d 736, 738 (11th Cir.2004) (concluding that this Court reviews any discovery order for abuse of discretion). This argument is wholly without merit. The bankruptcy court has wide discretion with respect to such discovery matters. A broad inquiry was necessary here to establish, for example, that Vision's policies may result in continued litigation, thus bolstering the case for the non-debtor releases.

G. Constitutionality of the Bankruptcy Decision

[25] Vision's initial brief has wholly failed to articulate a constitutional claim of arguable merit. Even if Vision had adequately *1084 asserted a takings claim, the extinguishing of a property interest through bankruptcy proceedings—even if the creditor receives nothing—does not constitute a taking. *In re Morel*, 983 F.2d 104, 105 (8th Cir.1992).

III. CONCLUSION

The bankruptcy court committed no reversible error by approving the Second Amended Plan.

AFFIRMED. 12

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

All Citations

780 F.3d 1070, 73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783, 25 Fla. L. Weekly Fed. C 989

Footnotes

- * Honorable Denise Cote, United States District Judge for the Southern District of New York, sitting by designation.
- 1 It is worth emphasizing here that Vision was never an unsecured creditor as to Seaside. Vision was an unsecured creditor as to Inlet Heights, LLC, and Costa Carina, LLC. Vision was only an equity holder in Seaside.
- Previous decisions of this Circuit have referred to non-debtor releases as "bar orders." *E.g. In re Munford*, 97 F.3d 449 (11th Cir.1996). The terms are used interchangeably in this opinion.
- "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. § 105(a).
- Munford thus places this Circuit within the majority view discussed below. Although the Fifth Circuit in In re Vitro S.A.B. DE C.V., 701 F.3d 1031, 1061 (2012), cited the Eleventh Circuit case of In re Jet Florida Systems, Inc., 883 F.2d 970 (1989), as being consistent with the minority view that non-consensual, non-debtor releases were prohibited by 11 U.S.C. § 524(e), the Fifth Circuit citation was misplaced. Our Jet Florida case did not involve a non-debtor release. Rather, it involved the usual injunction against actions against the debtor itself. The case involved a suit by a tort claimant against a debtor, after the discharge of the debtor, seeking to establish the liability of the debtor for the tort in order to obtain recovery against the debtor's insurer. We held that the injunction pursuant to 11 U.S.C. § 524(a) arising from the discharge of the debtor applied only with respect to the personal liability of the debtor. Id. at 973. In so holding, we quoted from Collier as follows:

The provisions of 524(a) apply only with respect to the *personal liability* of the debtor. When it is necessary to commence or continue a suit against a debtor in order, for example, to establish liability of another, perhaps a surety, such suit would not be barred. Section 524(e) was intended for the benefit of the debtor but was not meant to affect the liability of third parties or *to prevent establishing such liability* through whatever means required.

Id. at 973 (quoting 3 R. Babitt, A. Herzog, R. Mabey, H. Novikof, & M. Shinfeld, Collier on Bankruptcy, ¶ 524.01 at 524–16 (15th ed.1987) (emphasis added in Eleventh Circuit opinion)). Jet Florida held that the tort claimant could proceed with suit against the debtor to establish the fact of liability for purposes of the insurance coverage; and that, as a practical matter, the insurer would be required to defend because the debtor, protected from personal liability, would be free to default. Jet Florida, 883 F.2d at 976. Thus, nothing in Jet Florida addresses the issue before us—i.e., the authority of bankruptcy courts to issue a non-consensual, non-debtor release. And, contrary to the citation of the Fifth Circuit, nothing in Jet Florida suggests that the Eleventh Circuit is aligned with the minority view discussed below.

- 5 5–84 Collier Bankruptcy Practice Guide ¶ 84.02[1][c][v] (Alan N. Resnick & Henry J. Sommer eds., 2014).
- With respect to the Ninth Circuit, Collier cites In re Lowenschuss, 67 F.3d 1394, 1401–02 (9th Cir.1995), cert. denied, 517 U.S. 1243, 116 S.Ct. 2497, 135 L.Ed.2d 189 (1996), and In re American Hardwoods, Inc., 885 F.2d 621, 625–26 (9th Cir.1989). With respect to the Tenth Circuit, Collier cites In re Western Real Estate Fund, Inc., 922 F.2d 592, 601 (10th Cir.1990).
- Collier cites as support for this proposition: In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 292 (2d Cir.1992); In re Continental Airlines, 203 F.3d 203, 214 (3d Cir.2000); In re A.H. Robins Co., Inc., 880 F.2d 694, 700–02 (4th Cir.1989); In re Dow Corning Corp., 280 F.3d 648, 658 (6th Cir.2002); In re Specialty Equip. Cos., 3 F.3d 1043, 1047 (7th Cir.1993).

In re Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (2015)

73 Collier Bankr.Cas.2d 605, 60 Bankr.Ct.Dec. 212, Bankr. L. Rep. P 82,783...

Our research reveals that the Third Circuit in *Continental Airlines* expressly declined to decide whether or not there ought to be a blanket rule prohibiting all non-consensual releases and permanent injunctions of non-debtor obligations. Rather, the Third Circuit assumed the most flexible standard for testing the validity of such non-debtor releases, and held that the findings of fact below did not support such a bar order under that standard. 203 F.3d at 213–18. Our research also reveals that the Seventh Circuit case, *In re Airadigm Communications, Inc.*, 519 F.3d 640, 655–58 (7th Cir.2008), more squarely supports the majority position than does the case cited by *Collier*.

- 8 For this proposition, *Collier* cites *In re Munford, Inc.*, 97 F.3d 449 (11th Cir.1996); *In re Monarch Life Ins. Co.*, 65 F.3d 973, 984–85 (1st Cir.1995); and *In re AOV Industries*, 792 F.2d 1140, 1152 (D.C.Cir.1986).
- In *Munford* itself there was more identity as between the settling defendant and the non-settling defendants than between the settling defendant and the debtor. However, the gist of factor one—i.e., in the absence of the bar order, there will be a depletion of the assets of the debtor—was present. The same is true in this case.
- Vision argues that an additional provision of the Second Amended Plan serves as a broad release. "The treatment provided herein is in full satisfaction of all claims and interest such Holder has against the Debtor, the Reorganized Debtor, the Officers, Directors and Shareholders of the Debtor and the Members of the Reorganized Debtor." Seaside concedes that this provision is to be considered no broader with respect to non-debtors than the Bar Order quoted in Part II.B above.
- The bankruptcy court pointed to the obvious fact that § 1129(b)(2)(C) can be satisfied in either of two alternative ways: pursuant to (i) by paying the holder of the equity interest its full value, or by satisfaction of (ii) (the absolute priority rule). The bankruptcy court held that, because § 1129(b)(2)(C)(i) was satisfied, it need not address § 1129(b)(2)(C)(ii).
- 12 Seaside's Motion to Dismiss Appeal as Moot is DENIED.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

KeyCite Yellow Flag - Negative Treatment
Distinguished by In re Purdue Pharma, L.P., S.D.N.Y., December 16, 2021
945 F.3d 126

United States Court of Appeals, Third Circuit.

IN RE MILLENNIUM LAB HOLDINGS II, LLC., et al., Debtors Opt-Out Lenders, Appellant

No. 18-3210 | Argued September 12, 2019 | (Filed December 19, 2019)

Synopsis

Background: Confirmation hearing was held on debtors' proposed Chapter 11 plan, which provided for release of claims that nondebtor third parties might have against equity holders that had made a \$325 million contribution to debtors' reorganization. The United States Bankruptcy Court for the District of Delaware confirmed plan over non-consenting lenders' objection and, after lenders appealed, certified its decision for direct appeal to the Court of Appeals, 543 B.R. 703. The Court of Appeals denied permission to appeal, appeal was docketed in the district court, and debtors moved to dismiss appeal as equitably moot. The District Court, Leonard P. Stark, J., 242 F.Supp.3d 322, denied motion without prejudice and remanded for further proceedings. On remand, the Bankruptcy Court, Laurie Selber Silverstein, J., 575 B.R. 252, determined that it had constitutional authority to enter order confirming plan, and appeal was taken. The District Court, Stark, Chief Judge, 591 B.R. 559, affirmed. Lenders appealed.

Holdings: The Court of Appeals, Jordan, Circuit Judge, held that:

- [1] on the specific, exceptional facts of this case, the existence of the nonconsensual third-party releases and injunctions contained in the proposed reorganization plan was "integral to the restructuring of the debtor-creditor relationship," and so the bankruptcy court had constitutional authority to confirm the plan, and
- [2] the remainder of the appeal was equitably moot.

Affirmed.

West Headnotes (22)

[1] Constitutional Law 🧽 Delegation of Powers

Under the "public rights" exception to the exercise of judicial power contemplated by Article III, Congress may constitutionally allocate to "legislative," that is, non-Article III, courts the authority to resolve disputes that arise in connection with the performance of the constitutional functions of the executive or legislative departments. U.S. Const. art. 3, § 1 et seq.

[2] Constitutional Law & Establishment,
Organization, and Jurisdiction of Courts

Constitutional Law - Encroachment on Judiciary

"Public rights" exception to the exercise of judicial power contemplated by Article III is generally limited to cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert government agency is deemed essential to a limited regulatory objective within the agency's authority. U.S. Const. art. 3, § 1 et seq.

[3] Bankruptcy 🤛 Bankruptcy judges

Actions of a bankruptcy court may violate Article III even when the court is acting within its statutory authority in "core" matters. U.S. Const. art. 3, § 1 et seq.

1 Cases that cite this headnote

[4] Bankruptcy 🤛 Bankruptcy judges

Bankruptcy court is within constitutional bounds when it resolves a matter that is integral to the restructuring of the debtor-creditor relationship. U.S. Const. art. 3, § 1 et seq.

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

6 Cases that cite this headnote

[5] Bankruptcy — Claims or proceedings against estate or debtor; relief from stay

Bankruptcy 🧽 Bankruptcy judges

Because matters arising in the claims-allowance process are integral to the restructuring of the debtor-creditor relationship, bankruptcy courts can constitutionally decide matters arising in the claims-allowance process. U.S. Const. art. 3, § 1 et seq.

6 Cases that cite this headnote

[6] Courts 🦫 Supreme Court decisions

Regardless of the theory behind the Supreme Court's particular conclusion, the Court of Appeals is bound to follow the Supreme Court's teachings.

[7] Bankruptcy Related proceedings Bankruptcy Bankruptcy judges

For a bankruptcy court to have constitutional authority to resolve a matter, the matter need not stem from the bankruptcy itself; rather, the question governing the extent to which a bankruptcy court may constitutionally exercise power is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process. U.S. Const. art. 3, § 1 et seq.

1 Cases that cite this headnote

[8] Bankruptcy ← Core or non-core proceedings Bankruptcy ← Bankruptcy judges

When determining whether a bankruptcy court has acted within its constitutional authority, courts should generally focus not on the category of the "core" proceeding but, rather, on the content of the proceeding. U.S. Const. art. 3, § 1 et seq.

2 Cases that cite this headnote

[9] Bankruptcy 🤛 Counterclaims

Bankruptcy 🧽 Bankruptcy judges

Those counterclaims asserted by a debtor that do not stem from the bankruptcy itself or would not necessarily be resolved in the claims allowance process, and that therefore would not be integral to the restructuring of the debtor-creditor relationship, must be decided by Article III courts. U.S. Const. art. 3, § 1 et seq.

2 Cases that cite this headnote

[10] Bankruptcy - Particular proceedings or issues

Bankruptcy 🧽 Bankruptcy judges

On the specific, exceptional facts of the case, nonconsensual third-party releases and injunctions contained in debtors' proposed reorganization plan, in particular, provisions releasing and enjoining non-consenting lenders' claims against debtors' equity holders, were "integral to restructuring of debtor-creditor relationship," and so bankruptcy court, as a non-Article III court, had constitutional authority to confirm the plan; release provisions, agreed to only after extensive, arm's length negotiations, were absolutely required to induce equity holders to make \$325 million contribution to debtors' reorganization, such funds were needed to effectuate debtors' settlement with the government and prevent the government from revoking debtors' Medicare billing privileges, and absent the payment, no Chapter 11 plan would have been feasible, and liquidation would have been debtors' sole option. U.S. Const. art. 3, § 1 et seq.

4 Cases that cite this headnote

[11] Constitutional Law - Nature and scope in general

Since ratification, Article III has served a crucial role in the nation's "system of checks and balances," and preserves the integrity of judicial decisionmaking, U.S. Const. art. 3, § 1 et seq.

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

[12] Bankruptcy Settlement, adjustment, or enforcement of claims

The permissibility of nonconsensual third-party releases in reorganization plans is not broadly sanctioned; rather, exacting standards must be satisfied if these releases and injunctions are to be permitted, and courts considering such releases must do so with caution.

3 Cases that cite this headnote

[13] Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy 🧽 Confirmation; Objections

Bankruptcy courts have an obligation to approach the inclusion of nonconsensual third-party releases or injunctions in a plan of reorganization with the utmost care, and to thoroughly explain the justification for any such inclusion.

6 Cases that cite this headnote

[14] Bankruptcy • Moot questions

"Equitable mootness" is a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization.

[15] Bankruptcy 🧽 Moot questions

At bottom, equitable mootness assures the estate, the reorganized entity, investors, lenders, customers, and other constituents that a plan confirmation order is reliable and that they may make financial decisions based on a reorganized entity's exit from Chapter 11 without fear that an appellate court will wipe out or interfere with their deal.

[16] Bankruptcy ← Protection Against Discrimination or Collection Efforts in General; "Fresh Start."

One of the benefits of bankruptcy is its ability to aid the unfortunate debtor by giving him a fresh start in life.

[17] Bankruptcy • Moot questions

Equitable mootness allows the benefit of a "fresh start" to be realized by, among other things, encouraging an end to costly and protracted litigation based on arguable blemishes in a reorganization plan.

[18] Bankruptcy 🧽 Moot questions

An equitable mootness analysis proceeds by asking: (1) whether a confirmed plan has been substantially consummated, and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan, and/ or (b) significantly harm third parties who have justifiably relied on plan confirmation.

[19] Bankruptcy 🕪 Moot questions

On non-consenting lenders' appeal from confirmation order, remainder of appeal, beyond issue of bankruptcy court's constitutional authority to confirm plan, was equitably moot; plan was substantially consummated, and granting lenders the relief sought would lead to profoundly inequitable results, including giving lenders a windfall, harm numerous third parties, and fatally scramble the plan, as plan's broad nonconsensual third-party releases, which had been carefully crafted through extensive negotiations, were essential to plan, given that restructuring agreement stated that equity holders' settlement contribution was contingent on full and complete release of released parties and plan's severability provision stated that plan could not be altered to compel funding of settlement contribution if conditions to such funding set forth in restructuring agreement had

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

not been satisfied, and any do-over of plan would be massively disruptive and likely impossible.

2 Cases that cite this headnote

[20] Bankruptcy — Moot questions

Equitable mootness doctrine is designed to prevent inequitable outcomes.

[21] Equity - Application and operation in general

Equity abhors a windfall.

1 Cases that cite this headnote

[22] Bankruptcy — Construction, execution, and performance

Bankruptcy • Moot questions

Question of whether non-consenting lenders received consideration for the nonconsensual third-party releases contained in the confirmed Chapter 11 plan was a merits question, not an equitable mootness one.

2 Cases that cite this headnote

*129 On Appeal from the United States District Court for the District of Delaware (D.C. No. 1-17-cv-01461), District Judge: Leonard P. Stark

Attorneys and Law Firms

Maya Ginsburg, Thomas E. Redburn, Jr. [ARGUED], Sheila A. Sadighi, Lowenstein Sandler, One Lowenstein Drive, Roseland, NJ 07068, L. Katherine Good, Aaron H. Stulman, Christopher M. Samis, Potter Anderson & Corroon, 1313 N. Market Street, Hercules Plaza, 6th Fl., P.O. Box 951, Wilmington, DE 19801, Counsel for Appellant

John C. O'Quinn [ARGUED], Jason M. Wilcox, Kirkland & Ellis, 1301 Pennsylvania Avenue, N.W., Washington, DC 20004, Counsel for Appellee James Slattery

Derek C. Abbott, Joseph C. Barsalona, II, Andrew R. Remming, Morris Nichols Arsht & Tunnell, 1201 Market Street – 16th Fl., P.O. Box 1347, Wilmington, DE 19801,

Gregory W. Fox, Michael H. Goldstein, William P. Weintraub, Goodwin Procter, 620 Eighth Avenue, The New York Times Building, New York, NY 10018, Counsel for Appellee TA Millennium Inc.

Ryan M. Bartley, Pauline K. Morgan, Michael R. Nestor, Young Conaway Stargatt & Taylor, 1000 N. King Street, Wilmington, DE 19801, Richard P. Bress, Latham & Watkins, 555 11th Street, N.W. – Ste. 1000, Washington, DC 20004, Amy C. Quartarolo, Michael J. Reiss, Latham & Watkins, 355 S. Grand Avenue – Ste. 100, Los Angeles, CA 90071, Counsel for Debtor

Before: CHAGARES, JORDAN, and RESTREPO, Circuit Judges.

OPINION OF THE COURT

JORDAN, Circuit Judge.

We are asked whether the Bankruptcy Court, without running afoul of Article III of the Constitution, can confirm a Chapter 11 reorganization plan containing nonconsensual third-party releases and injunctions. On the specific, exceptional facts of this case, we hold that the Bankruptcy Court was permitted to confirm the plan because the existence of the releases and injunctions was "integral to the restructuring of the debtorcreditor relationship." *Stern v. Marshall*, 564 U.S. 462, 497, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011) (internal quotation marks and citation omitted). We further conclude that the remainder of this appeal is equitably moot, and we will therefore affirm the decision of the District Court.

I. Background

The debtors before the Bankruptcy Court and District Court were Millennium Lab Holdings II, LLC ("Holdings"), its wholly-owned subsidiary, Millennium Health LLC, and RxAnte, LLC, a wholly-owned *130 subsidiary of Millennium Health LLC, all of which we will refer to collectively as "Millennium." Millennium (as reorganized), along with certain of its direct and indirect pre-reorganization shareholders, specifically TA Millennium, Inc. ("TA"), TA Associates Management, L.P., and James Slattery, are the Appellees in this matter.

Millennium provides laboratory-based diagnostic services. In April 2014, it entered into a \$1.825 billion credit agreement with a variety of lenders, including a variety of funds and

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

accounts managed by Voya Investment Management Co. LLC and Voya Alternative Asset Management LLC which, for convenience, we will refer to collectively as "Voya." Ultimately, Millennium used the proceeds from the 2014 credit agreement to refinance certain of its then-existing financial obligations and to pay a nearly \$1.3 billion special dividend to its shareholders.

In March 2015, following a several-year investigation that dated back to at least 2012, the U.S. Department of Justice ("DOJ") filed a complaint in the United States District Court for the District of Massachusetts against Millennium, alleging violations of various laws, including the False Claims Act. Less than a month earlier, the Center for Medicare and Medicaid Services ("CMS") had notified Millennium that it would be revoking Millennium's Medicare billing privileges, the lifeblood of Millennium's business. In May 2015, Millennium reached an agreement in principle with the DOJ, CMS, and other government entities to pay \$256 million to settle various claims against it.

Shortly thereafter, however, Millennium concluded that it lacked adequate liquidity to both service its debt obligations under the 2014 credit agreement and make the required settlement payment to the government. Millennium thus informed the 2014 credit agreement lenders of the government's claims and the decision to settle, prompting the formation of an ad hoc group of lenders, of which Voya was a member, to begin working with Millennium and its primary shareholders, TA and Millennium Lab Holdings, Inc. ("MLH"), to negotiate a transaction that would allow the company to satisfy the settlement requirements and restructure its financial obligations. As those negotiations progressed, the ad hoc group began suggesting that there were potential claims against MLH and TA relating to the 2014 credit agreement, including a lack of disclosure regarding the government's investigation into Millennium's business. Millennium, MLH, TA, and the ad hoc group began discussing how to resolve those potential claims.

While negotiating with the ad hoc group, Millennium informed the government that it could not pay the \$256 million settlement without restructuring its other financial obligations. The government ultimately set a deadline of October 2, 2015, "by which the Company was required to finalize a proposal supported by the prepetition lenders and the Equity Holders[.]" (App. at 2231.) That deadline was later pushed to October 16 in exchange for, among other things, a \$50 million settlement deposit to be paid for by Millennium and guaranteed by MLH and TA.

On October 15, 2015, Millennium, its equity holders, and the ad hoc group - Voya excepted - entered into a restructuring support agreement (the "Restructuring *131 Agreement" or "Agreement"), which provided for either an out-of-court restructuring or a Chapter 11 reorganization of Millennium's business. Under the Agreement, MLH and TA agreed to pay \$325 million, which would be used to reimburse Millennium for the \$50 million settlement deposit, pay the remainder of the \$256 million settlement, and cover certain of Millennium's fees, costs, and working capital requirements. The Agreement also required Millennium's equity holders, including MLH and TA, to transfer 100% of the equity interests in Millennium to the company's lenders. Voya would receive its share of equity in the deal. In exchange, MLH, TA, and various others were to "receive full releases" for themselves and related parties regarding all claims arising from conduct that occurred before the Restructuring Agreement, including anything related to the 2014 credit agreement, and, in the case of a Chapter 11 reorganization, those individuals and entities covered by the Restructuring Agreement were to "be subject to a bar order, an injunction and related protective provisions" to enforce the releases. (App. at 518.) As a result of the Restructuring Agreement, Millennium was able to enter a final settlement with the government on October 16, 2015, which required payment of the settlement deposit in October and payment of the remainder of the settlement by December 30, 2015.

The Restructuring Agreement was reached only after intensive negotiations. Indeed, the negotiations were described by participants as "highly adversarial[,]" "extremely complicated[,]" and at "arm's-length," and in those negotiations "the parties all were represented by sophisticated and experienced professionals." (App. at 2229-30.) MLH and TA rejected the ad hoc group's suggestion of potential claims against them. "[P]rior to substantive negotiations commencing, it did not appear that [MLH and TA] had signaled a willingness to pay even any portion of the proposed ... settlement." (App. at 2230.) Rather, they were only "willing to consider a tender of their equity ownership of the Company in exchange for broad general releases[.]" (App. at 2230.)

From at least mid-August 2015, negotiations took place "on an almost daily basis[.]" (App. at 2231.) Before September 30, however, and despite "extensive negotiations between

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

the Equity Holders and the Ad Hoc Group during the prior months, the Equity Holders' last and 'best' offer was, in addition to turning over the Company's equity to the Lenders, \$275 million[,] and the Ad Hoc Group ... had demanded a \$375 million contribution[.]" (App. at 2232-33.)

The impasse was broken during the negotiation session that occurred on September 30. That session was viewed as "do or die" for Millennium and as having "decisive implications for the lenders and the equity" because, if the October 2 deadline was not met, the government would revoke Millennium's Medicare billing privileges. (App. at 2231-32.) In the last event, MLH and TA increased their offer to \$325 million, and the ad hoc group of lenders agreed to the revised terms. According to an individual involved in the negotiations, that deal - later embodied in the Agreement - was "the best possible deal achievable" and left nothing else "on the table[.]" (App. at 2233.)

The release provisions MLH and TA obtained in exchange for their contribution, were, in short, "heavily negotiated among the Debtors, the Equity Holders and the Ad Hoc Group" and necessary to the entire agreed resolution. (App. at 2234.) They "were specifically demanded by the Equity Holders as a condition to making the[ir] contribution" and, without *132 them, MLH and TA "would not have agreed" to the settlement. (App. at 2234.) The contribution was, of course, also necessary to induce the lenders' support of the Agreement. Thus, as stated by both the Bankruptcy Court and District Court after careful fact finding, the deal to avoid corporate destruction would not have been possible without the third-party releases.

After entering into the Restructuring Agreement, the parties thereto initially sought to reorganize Millennium out of court, and "over 93% of the Prepetition Lenders by value" agreed to do so. (App. at 1205.) That, however, was not enough. Voya held out, and Millennium filed its petition for bankruptcy in November 2015. It submitted to the Bankruptcy Court a "Prepackaged Joint Plan of Reorganization of Millennium Lab Holdings II, LLC, et al." that reflected the terms of the Restructuring Agreement.² (App. at 407.) The plan contained broad releases, including ones that would bind nonconsenting lenders such as Voya, in favor of Millennium, MLH, and TA, among others. Those releases specifically covered any claims "arising out of, or in any way related to in any manner," the 2014 credit agreement. (App. at 416.) To enforce the releases, the plan also provided for a bar order and an injunction prohibiting those bound by the releases from

commencing or prosecuting any actions with respect to the claims released under the plan.

Vova objected to confirmation of the plan.³ It explained that it intended to assert claims against MLH and TA for what it said were material misrepresentations made in connection with the 2014 credit agreement. In Voya's view, at the time of the credit agreement, Millennium knew of the legal scrutiny it was under by the government but made "affirmative representations ... which specifically indicated that there was no investigation pending that could result in a material adverse situation[,]" and Millennium further represented that it was not doing anything potentially illegal. (App. at 1309.) Voya thus asserted that it had significant legal claims against Millennium and Millennium's equity holders, that the releases of the equity holders were unlawful, and that the Bankruptcy Court lacked subject matter jurisdiction to approve them.

The Bankruptcy Court overruled Voya's objections and confirmed the plan on December 14, 2015.4 Voya then appealed to the District Court, arguing, among other things, that the Bankruptcy Court lacked the constitutional authority to order the releases and injunctions. In response, the Appellees, all of whom are named as released parties in the confirmed plan, moved to dismiss, pressing especially that the case is equitably moot. The District Court, however, remanded the case for the Bankruptcy Court to consider whether it - the Bankruptcy Court - had constitutional authority to confirm a plan releasing Voya's claims, in light of the Supreme Court's decision in Stern v. Marshall, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

*133 On remand, the Bankruptcy Court wrote a detailed and closely reasoned opinion explaining its conclusion that it had constitutional authority. It said that Stern is inapplicable when, as in this instance, the proceeding at issue is plan confirmation, and that, even if *Stern* did apply, the limitations imposed by that precedent would be satisfied. Voya appealed and the Appellees moved again to dismiss the matter as equitably moot.

The District Court, in an equally thoughtful opinion, affirmed the Bankruptcy Court's ruling on constitutional authority, reasoning, in relevant part, that Stern is inapplicable to plan confirmation proceedings. The Court then dismissed the remainder of Voya's challenges as equitably moot because the releases and related provisions were central to the reorganization plan and excising them would unravel the plan, and because it would be inequitable to allow Voya to benefit

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

from the restructuring while also pursuing claims that MLH and TA had paid to settle. Finally, in the alternative, the District Court reasoned that, even if the Bankruptcy Court lacked constitutional authority to confirm the plan, and even if the appeal were not equitably moot, the District Court itself would affirm the confirmation order by rejecting Voya's challenges on the merits.

This timely appeal followed.

II. Discussion⁵

The Parties press a number of arguments, but we need only address two: first, whether the Bankruptcy Court had constitutional authority to confirm the plan releasing and enjoining Voya's claims against MLH and TA; and second, whether this appeal, including Voya's arguments that the release provisions violate the Bankruptcy Code, is otherwise equitably moot. Because the answer to both of those questions is yes, we will affirm.

A. The Bankruptcy Court Possessed the Constitutional Authority to Confirm the Plan Containing the Release Provisions

Voya's primary argument is that, under the reasoning of *Stern* v. *Marshall*, the Bankruptcy Court lacked the constitutional authority to confirm a plan releasing its claims. ⁶ To explain why we disagree, we first consider the reach of *Stern* and then how the decision applies here.

i. The Reasoning and Reach of Stern v. Marshall

In *Stern*, the son of a deceased oil magnate filed an adversary complaint in bankruptcy court against his stepmother for defamation and also "filed a proof of claim for the defamation action, meaning that he *134 sought to recover damages for it from [the] bankruptcy estate." 564 U.S. at 470, 131 S.Ct. 2594. The dispute was part of a long running battle over the oil magnate's estate, and the stepmother – who was the debtor in bankruptcy – responded to the defamation claim by asserting truth as a defense and filing her own counterclaim for tortiously interfering with a gift (*i.e.*, a trust of which she would be the beneficiary) that she had expected to receive from her late husband. *Id.* The bankruptcy court granted summary judgment for the stepmother on the defamation claim and then, after a bench trial, ruled in her favor on the tortious interference counterclaim. *Id.*

The main issue before the Supreme Court was whether the bankruptcy court had the authority to adjudicate the counterclaim. The Court first decided that the bankruptcy court was statutorily authorized to do so. *Id.* at 475-78, 131 S.Ct. 2594. It said that bankruptcy courts may hear and enter final judgments in what the bankruptcy code frames as "core proceedings," and the Court further ruled that the counterclaim was such a proceeding because, under 28 U.S.C. § 157(b)(2)(C), "core proceedings include 'counterclaims by the [bankruptcy] estate against persons filing claims against the estate.' "Stern, 564 U.S. at 475, 131 S.Ct. 2594.

Nevertheless, the Supreme Court concluded that the bankruptcy court's actions violated Article III of the U.S. Constitution. Id. at 482, 131 S.Ct. 2594. Quoting Northern Pipeline Construction Company v. Marathon Pipe Line Company, 458 U.S. 50, 90, 102 S.Ct. 2858, 73 L.Ed.2d 598 (1982) (Rehnquist, J., concurring in judgment), the Court reasoned that, "[w]hen a suit is made of 'the stuff of the traditional actions at common law tried by the courts at Westminster in 1789,' and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts." Stern, 564 U.S. at 484, 131 S.Ct. 2594. The bankruptcy court had gone beyond constitutional limits when it "exercised the 'judicial Power of the United States' in purporting to resolve and enter final judgment on a state common law claim[.]" Id. at 487, 131 S.Ct. 2594.

[1] [2] The Supreme Court went on to explain that the counterclaim also not did fall within the "public rights" exception to the exercise of judicial power contemplated by Article III. Under the public rights exception, Congress may constitutionally allocate to "legislative" - i.e., non-Article III – courts the authority to resolve disputes that arise "in connection with the performance of the constitutional functions of the executive or legislative departments[.]" Id. at 489, 131 S.Ct. 2594 (citation omitted). Although acknowledging that the exception is not well defined, the Court explained that it is generally limited to "cases in which the claim at issue derives from a federal regulatory scheme, or in which resolution of the claim by an expert Government agency is deemed essential to a limited regulatory objective within the agency's authority." Id. at 490, 131 S.Ct. 2594. The Court had little difficulty concluding that the stepmother's counterclaim, which arose "under state common law between two private parties," and, at best, had a highly tenuous connection to federal law, did not "fall within any *135 of

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

the varied formulations of the public rights exception[.]" *Id.* at 493, 131 S.Ct. 2594. But the Court made clear that it had never decided and was not then deciding whether "the restructuring of debtor-creditor relations is in fact a public right." *Id.* at 492 n.7, 131 S.Ct. 2594 (citation omitted).

The Supreme Court also rejected the stepmother's argument that her counterclaim could be decided in bankruptcy court because the stepson had filed a proof of claim. Id. at 495, 131 S.Ct. 2594. In doing so, though, the Court interpreted two of its previous opinions as concluding that matters arising in the claims-approval process could be adjudicated by a bankruptcy court. Id. at 495-97, 131 S.Ct. 2594. The Court said that Katchen v. Landy, 382 U.S. 323, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966), stood for the proposition that a "voidable preference claim" could be decided by a bankruptcy adjudicator "because it was not possible for the [adjudicator] to rule on the creditor's proof of claim without first resolving the voidable preference issue." Stern, 564 U.S. at 496, 131 S.Ct. 2594. It further observed that its decision in Langenkamp v. Culp, 498 U.S. 42, 111 S.Ct. 330, 112 L.Ed.2d 343 (1990) (per curiam), was "to the same effect" and had concluded "that a preferential transfer claim can be heard in bankruptcy when the allegedly favored creditor has filed a claim, because then [i.e., after the creditor's claim has been filed,] 'the ensuing preference action by the trustee become[s] integral to the restructuring of the debtorcreditor relationship.' " Stern, 564 U.S. at 497, 131 S.Ct. 2594 (second alteration in original) (citation omitted). The Court distinguished that situation from the dispute before it in Stern because there was little overlap between the debtor-stepmother's tortious interference counterclaim and the creditor-stepson's defamation claim and "there was never any reason to believe that the process of adjudicating [the] proof of claim would necessarily resolve [the] counterclaim." Id. Finally, it explained that, "[i]n both Katchen and Langenkamp, ... the trustee bringing the preference action was asserting a right of recovery created by federal bankruptcy law[,]" but the stepmother's counterclaim was "in no way derived from or dependent upon bankruptcy law; it [was] a state tort action that exist[ed] without regard to any bankruptcy proceeding." Id. at 498-99, 131 S.Ct. 2594. The Court concluded by saying "that Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case[.]" Id. at 499, 131 S.Ct. 2594. In language central to the issue before us, the Court said, "the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." Id.

[3] Stern makes several points that are important here. First, bankruptcy courts may violate Article III even while acting within their statutory authority in "core" matters. Cf. Exec. Benefits Ins. Agency v. Arkison, 573 U.S. 25, 30-31, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014) (describing "Stern claims" as "claim[s] designated for final adjudication in the bankruptcy court as a statutory matter, but prohibited from proceeding in that way as a constitutional matter"). Thus, even in cases in which a bankruptcy court exercises its "core" statutory authority, it may be necessary to consider whether that exercise of authority comports with the Constitution.

[7] Second, a bankruptcy court is within [5] [6] constitutional bounds when it resolves a matter that is integral to the restructuring of the debtor-creditor relationship. The Stern Court relied on Katchen and Langenkamp as examples of a bankruptcy court's constitutionally appropriate *136 adjudication of claims. Of particular note, and as quoted earlier, the Court in discussing Langenkamp said that it held there that a particular "claim can be heard in bankruptcy when the ... creditor has filed a claim, because then 'the ensuing preference action by the trustee become[s] integral to the restructuring of the debtor-creditor relationship.' " Stern, 564 U.S. at 497, 131 S.Ct. 2594 (alteration in original) (citation omitted). In other words, the Court concluded that bankruptcy courts can constitutionally decide matters arising in the claims-allowance process, and they can do that because matters arising in the claims-allowance process are integral to the restructuring of the debtor-creditor relationship. 8 Id. at 492 n.7, 497, 131 S.Ct. 2594 (citations omitted). Furthermore, the Supreme Court made it clear that, for there to be constitutional authority, a matter need not stem from the bankruptcy itself. That is evident from its declaration of a two-part disjunctive test. The Court said that "the question [governing the extent to which a bankruptcy court may constitutionally exercise power] is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." Id. at 499, 131 S.Ct. 2594 (emphasis added).

[8] [9] The third take-away from *Stern* is that, when determining whether a bankruptcy court has acted within its constitutional authority, courts should generally focus not on the category of the "core" proceeding but rather on the content of the proceeding. The *Stern* Court never said that *all* counterclaims by a debtor are beyond the reach of bankruptcy courts. Rather, it explained that those that do not "stem[] from the bankruptcy itself or would [not]

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

necessarily be resolved in the claims allowance process" (and therefore would not be integral to the restructuring of the debtor-creditor relationship) must be decided by Article III courts. *Id.* at 497, 499, 131 S.Ct. 2594. And, the Court looked to the content of the debtor's counterclaim in applying that test. It compared the factual and legal determinations necessary to resolve the tortious interference counterclaim to those necessary to resolve the defamation claim to assess whether the counterclaim would necessarily be resolved in the claims-allowance process, and it looked to the basis for the counterclaim to determine whether it stemmed from the bankruptcy itself. *Id.* at 498-99, 131 S.Ct. 2594.

*137 In sum, *Stern* teaches that the exercise of "core" statutory authority by a bankruptcy court can implicate the limits imposed by Article III. Such an exercise of authority is permissible if it involves a matter integral to the restructuring of the debtor-creditor relationship. And, in determining whether that is the case, we can consider the content of the "core" proceeding at issue.

ii. The Bankruptcy Court Had Constitutional Authority Under Stern

[10] Applying the foregoing principles to the case at hand leads to the conclusion that the Bankruptcy Court possessed constitutional authority to confirm the plan containing the release provisions. The Bankruptcy Court indisputably had "core" statutory authority to confirm the plan. See 28 U.S.C. § 157(b)(2)(L) ("Core proceedings include, but are not limited to ...[,] confirmations of plans[.]"). The question is whether, looking to the content of the plan, the Bankruptcy Court was resolving a matter integral to the restructuring of the debtor-creditor relationship. The only terms at issue are the provisions releasing and enjoining Voya's claims.

Those provisions were thoroughly and thoughtfully addressed by the Bankruptcy Court. It held that "[t]he injunctions and releases provisions are critical to the success of the Plan" because, "[w]ithout the releases, and the enforcement of such releases through the Plan's injunction provisions, the Released Parties [would not be] willing to make their contributions under the Plan" and, "[a]bsent those contributions, the Debtors [would] be unable to satisfy their obligations under the USA Settlement Agreements [i.e., the settlement with the government] and no chapter 11 plan [would] be feasible and the Debtors would likely [have] shut down upon the revocation of their Medicare enrollment and billing

privileges." (App. at 24; see also App. at 3596, 3598 (the Bankruptcy Court stating that "it is clear that the releases are necessary to both obtaining the funding and consummating a plan" and that "[w]ithout [MLH and TA's] contributions, there is no reorganization").) Those conclusions are well supported by the record. (App. at 1575-80, 2230, 2233-35; D. Ct. D.I. 25-2, at *233-34.) Indeed, the record makes abundantly clear that the release provisions - agreed to only after extensive, arm's length negotiations - were absolutely required to induce MLH and TA to pay the funds needed to effectuate Millennium's settlement with the government and prevent the government from revoking Millennium's Medicare billing privileges. Absent MLH and TA's payment, the company could not have paid the government, with the result that liquidation, not reorganization, would have been Millennium's sole option. Restructuring in this case was possible only because of the release provisions.

To Voya, that point is irrelevant. 11 Voya contends that *Stern* demands an Article III adjudicator decide its RICO/fraud claims because those claims do not stem *138 from the bankruptcy itself and would not be resolved in the claims-allowance process. It asserts that the limiting phrase from *Stern*, *i.e.*, "necessarily be resolved in the claims allowance process[,]" cannot be stretched to cover all matters integral to the restructuring. (Opening Br. at 31.) In that regard, Voya argues that an assertion that something is "integral to the restructuring" is really "nothing more than a description of *the claims allowance process.*" (Reply Br. at 13.)

That argument fails primarily because it is not faithful to what Stern actually says. Had the Stern Court meant its "integral to the restructuring" language to be limited to the claimsallowance process, it would not have said that a bankruptcy court may decide a matter when a "creditor has filed a claim, because then" - adding its own emphasis to that word - "the ensuing preference action by the trustee become[s] integral to the restructuring of the debtor-creditor relationship." 564 U.S. at 497, 131 S.Ct. 2594 (alteration in original). That phrasing makes clear that the reason bankruptcy courts may adjudicate matters arising in the claims-allowance process is because those matters are integral to the restructuring of debtor-creditor relations, not the other way around. And, as the Appellees correctly observe, Stern is not the first time that the Supreme Court has so indicated. In Granfinanciera, S.A. v. Nordberg, 492 U.S. 33, 109 S.Ct. 2782, 106 L.Ed.2d 26 (1989) – a case that the *Stern* Court viewed as informing its Article III jurisprudence, 564 U.S. at 499, 131 S.Ct. 2594 the Court answered first whether an action arose in the claims-

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

allowance process and only then whether it was otherwise integral to the restructuring of debtor-creditor relations. *See Granfinanciera*, 492 U.S. at 58, 109 S.Ct. 2782 ("Because petitioners here ... have not filed claims against the estate, respondent's fraudulent conveyance action does not arise 'as part of the process of allowance and disallowance of claims.' Nor is that action integral to the restructuring of debtor-creditor relations."). ¹² If the first *139 step in that analysis were all that was relevant, the second step would not have been taken.

[11] Voya also raises a "floodgate" argument, saying that, if we allow bankruptcy courts to approve releases merely because they appear in a plan, bankruptcy courts' powers would be essentially limitless and that an "integral to the restructuring" rule would mean that bankruptcy courts could approve releases simply because reorganization financers demand them, which could lead to gamesmanship. The argument is not without force. Setting too low a bar for the exercise of bankruptcy court authority could seriously undermine Article III, which is fundamental to our constitutional design. 13 It is definitely not our intention to permit any action by a bankruptcy court that could "compromise" or "chip away at the authority of the Judicial Branch[,]" Stern, 564 U.S. at 503, 131 S.Ct. 2594, and our decision today should not be read as expanding bankruptcy court authority.

[12] [13] Nor should our decision today be read as permitting or encouraging the hypothetical gamesmanship that Voya fears will now ensue. Consistent with prior decisions, we are not broadly sanctioning the permissibility of nonconsensual third-party releases in bankruptcy reorganization plans. Our precedents regarding nonconsensual third-party releases and injunctions in the bankruptcy plan context set forth exacting standards that must be satisfied if such releases and injunctions are to be permitted, and suggest that courts considering such releases do so with caution. See In re Global Indus. Techs., Inc., 645 F.3d 201, 206 (3d Cir. 2011) (en banc) (explaining that suit injunctions must be "both necessary to the reorganization and fair"); In re Continental Airlines, Inc., 203 F.3d 203, 214 (3d Cir. 2000) ("The hallmarks of permissible non-consensual releases [are] fairness, necessity to the reorganization, and specific factual findings to support these conclusions[.]"). Although we are satisfied that both the Bankruptcy Court and District Court exercised appropriate - indeed, exemplary - caution and diligence in this instance, nothing in our opinion should be construed as reducing a court's obligation to

approach the inclusion of nonconsensual third-party releases or injunctions in a plan of reorganization with the utmost care and to thoroughly explain the justification for any such inclusion.

*140 In short, our holding today is specific and limited. It is that, under the particular facts of this case, the Bankruptcy Court's conclusion that the release provisions were integral to the restructuring was well-reasoned and well-supported by the record. Consequently, the bankruptcy court was constitutionally authorized to confirm the plan in which those provisions appeared.

B. The Remainder of the Appeal Is Equitably Moot

Voya next argues that the District Court erred in concluding that the remaining issues on appeal are equitably moot. Again, we disagree.

[14] [15] [16] [17] "'Equitable mootness' is a narrow doctrine by which an appellate court deems it prudent for practical reasons to forbear deciding an appeal when to grant the relief requested will undermine the finality and reliability of consummated plans of reorganization." *In re Tribune Media Co.*, 799 F.3d 272, 277 (3d Cir. 2015). At bottom, "[e]quitable mootness assures [the estate, the reorganized entity, investors, lenders, customers, and other constituents] that a plan confirmation order is reliable and that they may make financial decisions based on a reorganized entity's exit from Chapter 11 without fear that an appellate court will wipe out or interfere with their deal." 16 *Id.* at 280.

[18] [19] An equitable mootness analysis proceeds by asking two questions: "(1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation." *Id.* at 278. Voya concedes that the *141 plan here is substantially consummated, so we focus on the second question. Answering it shows that the appeal is indeed equitably moot.

Granting Voya the relief it seeks would certainly scramble the plan. As the District Court explained, "[t]he Bankruptcy Court found [Voya's] releases were central to the Plan and, far from being clearly erroneous, [that conclusion] is strongly supported by uncontroverted evidence in the record." (App. at 374.) The Bankruptcy Court observed,

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

based on unrefuted evidence, that the "third-party releases, all of them, ... [were] required to obtain the funding for this plan" (App. at 3594 (emphasis added)); that "the releases [were] necessary to ... consummating a plan" (App. at 3596); and that "[w]ithout [TA and MLH's] contributions, there is no reorganization." (App. at 3598.) The release provisions, carefully crafted through extensive negotiations, served as the cornerstone of the reorganization and, hence, of Millennium's corporate survival. Notably, the confirmed plan contains a severability provision stating, "no alteration or interpretation [of the plan] can ... compel the funding of Settlement Contribution if the conditions to such funding set forth in the [Restructuring Agreement] have not been satisfied" (App. at 142), and the Restructuring Agreement, in turn, says that the settlement contribution is contingent on "a full and complete release of ... the Released Parties" and an injunction to enforce the release. (App. at 196 (emphasis added).) As the Bankruptcy Court recognized, all of the releases were essential to the plan.

But even if some subset of the release provisions could be deemed non-essential, it would not be Voya's. Voya loaned more than \$100 million to Millennium through the 2014 credit agreement. Its lawsuit raises several claims based on that loan, including RICO, fraud, and restitution claims. 17 The restitution claim alone seeks "restitution of [Voya's] funds," among other relief (App. at 2355), and presumably the other claims seek damages based on the loan amount, trebled for the RICO claims. Opening MLH, TA, and their related parties to well over \$100 million in liability, above the \$325 million that was negotiated and paid to settle those same claims, would completely undermine the purpose of the release provisions. And again, based on the intense, arm's length negotiations, those provisions were included because they were essential to obtaining the payment that allowed Millennium's survival. Given the centrality of the release provisions to the reorganization, excising them would undermine the fundamental basis for the parties' agreement.

Furthermore, any do-over of the plan at this time would likely be impossible and, even if it could be done, would be massively disruptive. Since the plan was confirmed, Millennium has paid the government, has "completed numerous complex restructuring and related transactions," and has distributed common stock to the lenders under the 2014 credit agreement. (App. at 6195, 6199.) In addition, "unsecured creditors [have been] paid the full amount of their allowed claims" (Supp. App. at 3); Millennium's lender and equity base has changed dramatically; the company has

sold off RxAnte; and it "has entered into more than two million commercial transactions, many of which are with new counterparties." (Supp. App. at 5.) It *142 is inconceivable that these many post-confirmation developments could be unwound, particularly those involving the government.

In that same vein, the relief that Voya seeks would seriously harm a wide range of third parties. If the plan could somehow be unwound and Millennium put back in its pre-confirmation position, the interests and expectations of Millennium's new lenders and equity holders — who certainly invested in reliance on the reorganization — would be wholly undermined. RxAnte's acquiror would in turn have to unwind that acquisition; contracts and transactions with counterparties would be scuttled; and the status of Millennium and all of its employees and contractors would obviously be placed in severe jeopardy.

Our decision in *In re Tribune* is on point. There, a confirmed plan contained provisions settling certain claims by the estate against various parties connected with a leveraged buyout of the debtor. In re Tribune, 799 F.3d at 275-76. The appellant, a creditor, conceded that the plan was substantially consummated but argued that the relief it sought - reinstatement of settled causes of action - would not fatally harm the plan or third parties. *Id.* at 277, 280. We thought otherwise and said that allowing the suits barred by the settlement "would knock the props out from under the authorization for every transaction that has taken place, thus scrambling this substantially consummated plan and upsetting third parties' reliance on it." Id. at 281 (citations and internal quotation marks omitted). We observed that the settlement was "a central issue in the formulation of a plan of reorganization" and that "allowing the relief the appeal seeks would effectively undermine the Settlement (along with the transactions entered in reliance on it) and, as a result, recall the entire Plan for a redo." Id. at 280-81. It was plain that third parties would be harmed because, among other things, "returning to the drawing board would at a minimum drastically diminish the value of new equity's investment[,]" which "no doubt was [made] in reliance on the Settlement[.]" Id. at 281. That same reasoning applies with great force in this case.18

Voya raises several unpersuasive arguments challenging the District Court's equitable mootness decision. In spite of all the evidence, it contends that striking the release provisions only as to it would not cause the plan to collapse. It says that the remainder of the plan would stay in place, *143

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

including the release provisions as to other parties, given that the other lenders consented. According to Voya, nothing in the plan would authorize MLH and TA to demand the return of their contribution if the release provisions were stricken, and it claims that, in fact, the plan anticipates "just such a scenario and gives [MLH and TA] ... the ability to access insurance coverage and/or indemnification from Debtors (capped at \$3 million) for defense costs." (Opening Br. at 50.) But, as explained above, striking the release provisions as to Voya would certainly undermine the plan. That the plan provides for "insurance coverage and/or indemnification" as a contingency does not change that. As previously noted, the plan says that the settlement payment, the very payment on which Millennium's viability as a going concern depended, could not be compelled absent full and complete releases from all of Millennium's pre-bankruptcy lenders, including Voya.

Vova next argues that granting it relief will not disturb legitimate third-party expectations. As to that point, it declares that MLH and TA's reliance interests do not count, "both because they are relying on the Plan to obtain unlawful nonconsensual releases to which they are not legally entitled and because they are sophisticated parties who were intimately involved in constructing the Plan and fully aware of the appellate risks when they allowed it to be consummated." (Opening Br. at 53.) But, besides the circularity of its reasoning, Voya's position misses the mark, as it ignores the fact that numerous other third parties, including Millennium's new post-bankruptcy equity holders and lenders, would be harmed significantly by any effort to unwind the plan.

[21] [22] Voya also raises a series of arguments equitably moot. [20] claiming that it would be fair to strike the releases as to it while not returning any of MLH and TA's contribution and without requiring Voya to return any of the value it obtained by way of the reorganization. ¹⁹ Each of those arguments is a non-starter. Voya wants all of the value of the restructuring and none of the pain. That is a fantasy and upends the purpose of the equitable mootness doctrine, which is designed to prevent inequitable outcomes. Cf. In re PWS Holding Corp., 228 F.3d 224, 235-36 (3d Cir. 2000) ("Under the doctrine of equitable mootness, an appeal should be dismissed ... if the implementation of

that relief would be inequitable." (emphasis added)). "Equity abhors a windfall." US Airways, Inc. v. McCutchen, 663 F.3d 671, 679 (3d Cir. 2011), vacated on other grounds, 569 U.S. 88, 106, 133 S.Ct. 1537, 185 L.Ed.2d 654 (2013); Prudential Ins. Co. of Am. v. S.S. Am. Lancer, 870 F.2d 867, 871 (2d Cir. 1989). Voya would receive a windfall – at the substantial and uncompensated expense of MLH and TA - if we were to let it avoid the release provisions without requiring it to return the value it obtained through the reorganization consummated on the basis of those release provisions and without allowing MLH and TA to recover *144 their contribution. Voya's arguments also fail by their own terms. The question of whether Voya received consideration for the releases is a merits question, not an equitable mootness one. See In re United Artists Theatre Co., 315 F.3d 217, 227 (3d Cir. 2003) (explaining that non-consensual releases must be given in exchange for fair consideration, among other things). And, regardless of formal consideration, it would still be inequitable to let Voya retain the benefits of the settlement and still have the right to sue. See In re Tribune, 799 F.3d at 281 ("When determining whether the case is equitably moot, we of course must assume [the appellant] will prevail on the merits because the idea of equitable mootness is that even if [the appellant] is correct, it would not be fair to award the relief it seeks.").

In the end, the operative question for our equitable mootness inquiry is straightforward: would granting Voya relief fatally scramble the plan and/or harm third parties. The answer is clearly ves.²⁰ Granting Voya's requested relief would lead to profoundly inequitable results, and the District Court did not abuse its discretion in concluding that the appeal was

III. Conclusion

For the foregoing reasons, we will affirm the decision of the District Court.

All Citations

945 F.3d 126, Bankr. L. Rep. P 83,470

Footnotes

Slattery was the founder of Millennium, has served in high-level positions in the company, and established trusts "for the benefit of himself and/or members of his family [and which] own approximately 79.896 percent of the stock of [Millennium Lab Holdings, Inc.][,]" a substantial pre-reorganization shareholder of Millennium. (App. at 981.)

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

- 2 The plan was later amended to eliminate a disputed provision that is not at issue in this appeal.
- 3 The United States Trustee objected as well. Those objections are not at issue on appeal.
- A few days earlier, on December 9, 2015, Voya had filed suit against TA, MLH, and various affiliates in the District Court asserting RICO, RICO conspiracy, fraud and deceit, aiding and abetting fraud, conspiracy to commit fraud, and restitution claims. That case has been stayed pending the present litigation. *ISL Loan Tr. v. TA Assocs. Mgmt., L.P.*, No. 15-cv-1138 (D. Del.) (D.I. 11).
- While the Bankruptcy Court's authority is at issue, it had jurisdiction to consider this dispute pursuant to 28 U.S.C. §§ 157, 1334. The District Court had jurisdiction under 28 U.S.C. §§ 158(a), 1334, and we have jurisdiction under 28 U.S.C. §§ 158(d), 1291. U.S. Tr. v. Gryphon at Stone Mansion, Inc., 166 F.3d 552, 553 (3d Cir. 1999); In re Semcrude, L.P., 728 F.3d 314, 320 (3d Cir. 2013). "In reviewing the Bankruptcy Court's determinations, we exercise the same standard of review as did the District Court. We therefore review the Bankruptcy Court's legal determinations de novo and ... its factual determinations for clear error." In re Wettach, 811 F.3d 99, 104 (3d Cir. 2016) (citations and internal quotation marks omitted). "We review the [District] Court's equitable mootness determination for abuse of discretion." In re Semcrude, 728 F.3d at 320.
- The parties also contest whether the constitutionality of the Bankruptcy Court's decision is a threshold issue that must be decided before assessing equitable mootness. Since we conclude that the Bankruptcy Court possessed constitutional authority, we need not decide whether there is a set order of operations.
- Both the litigation culminating in the Supreme Court's *Stern* decision, and the *Stern* decision itself, received significant public attention based on the litigants' identities. The stepmother was the late Vickie Lynn Marshall, widely known as Anna Nicole Smith. The stepson was the late E. Pierce Marshall, son of the deceased oil magnate, J. Howard Marshall II.
- Again, and as noted on page *supra*, we recognize that the Supreme Court declined to determine whether, as a general matter, "restructuring of debtor-creditor relations is in fact a public right." *Stern*, 564 U.S. at 492 n.7, 131 S.Ct. 2594 (citation omitted). Thus, the Court's conclusion that bankruptcy courts can decide matters integral to the restructuring of debtor-creditor relations may not have been grounded in public rights doctrine. Indeed, Chief Justice Roberts, the author of *Stern*, has suggested as much. *Cf. Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 135 S. Ct. 1932, 1951, 191 L.Ed.2d 911 (2015) (Roberts, C.J., dissenting) ("Our precedents have also recognized an exception to the requirements of Article III for certain bankruptcy proceedings. When the Framers gathered to draft the Constitution, English statutes had long empowered nonjudicial bankruptcy 'commissioners' to collect a debtor's property, resolve claims by creditors, order the distribution of assets in the estate, and ultimately discharge the debts. This historical practice, combined with Congress's constitutional authority to enact bankruptcy laws, confirms that Congress may assign to non-Article III courts adjudications involving 'the restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power.' (internal citations omitted)). We need not identify the theory behind the Supreme Court's conclusion, however, because, regardless, "we are bound to follow [the Court's] teachings [.]" *St. Margaret Mem'l Hosp. v. NLRB*, 991 F.2d 1146, 1154 (3d Cir. 1993).
- To be sure, the Supreme Court made clear that the claims-allowance process a core proceeding under 28 U.S.C. § 157(b)(2)(B) is per se integral to the restructuring of the debtor-creditor relationship and, therefore, that the category of proceeding is controlling in that context. *Stern*, 564 U.S. at 497-99, 131 S.Ct. 2594. But we have no guidance as to whether any other categories of core proceedings might be treated similarly.
- The Appellees argue that a bankruptcy court can always constitutionally confirm a plan. We have our doubts about so broad a statement but we do not need to address it to decide this case.
- 11 In fact, Voya does not even argue in its briefing that the release provisions were not integral to the restructuring.
- Voya makes two additional arguments regarding the proper interpretation of *Stern*: that courts of appeals have interpreted *Stern* as centered on the claims-allowance process, and that the phrase "integral to the restructuring" is not supported by the Supreme Court's public rights jurisprudence. As to the former, we are not convinced that the out-of-circuit cases Voya cites are inconsistent with our reading of *Stern*. *Stern* on its face governed in those cases, so, unlike here, the courts

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

had no need to extract a principle beyond Stern's plain terms. See In re Renewable Energy Dev. Corp., 792 F.3d 1274, 1279 (10th Cir. 2015) (concluding that Stern provided "all the guidance we need to answer this appeal" because the case involved the assertion that state law legal malpractice claims against the bankruptcy trustee by clients of the trustee in his capacity as an attorney should be heard in bankruptcy court simply because the malpractice claims were "factually 'intertwined' with the bankruptcy proceedings"); In re Fisher Island Invs., Inc., 778 F.3d 1172, 1192 (11th Cir. 2015) (holding that Stern did not apply to bar bankruptcy court adjudication of a claim where, among other things, that claim "was 'necessarily resolve[d]' by the bankruptcy court through the process of adjudicating the creditors' claims" (alteration in original) (citation omitted)); In re Glob. Technovations Inc., 694 F.3d 705, 722 (6th Cir. 2012) (holding that a bankruptcy court's resolution of one issue was permissible under Stern because it was not possible to rule on a proof of claim without deciding the issue, and concluding that the bankruptcy court could decide a second issue that could have been necessary to ruling on a proof of claim but turned out not to be because the court did "not believe that Stern requires a court to determine, in advance, which facts will ultimately prove strictly necessary"); In re Bellingham Ins. Agency, Inc., 702 F.3d 553, 564-65 (9th Cir. 2012) (holding that a bankruptcy court could not resolve a fraudulent conveyance action similar to that in Granfinanciera - which the Stern Court made clear could not have been adjudicated by a bankruptcy court - because it "need not necessarily have been resolved in the course of allowing or disallowing the claims against the...estate"); In re Ortiz, 665 F.3d 906, 909, 912, 914 (7th Cir. 2011) (concluding that claims could not be decided by a bankruptcy court because the case essentially matched Stern); see also In re Ortiz, 665 F.3d at 914 ("Non-Article III judges may hear cases when the claim arises 'as part of the process of allowance and disallowance of claims,' or when the claim becomes 'integral to the restructuring of the debtor-creditor relationship[.]'" (citations omitted)). Voya also cites our decision in Billing v. Ravin, Greenberg & Zackin, P.A., 22 F.3d 1242 (3d Cir. 1994), but that decision predates Stern and offers no insight into how best to interpret it.

Voya's second argument, that the rule we adopt today would not comport with the Supreme Court's public rights doctrine, similarly is unavailing. As already noted (see supra n. 8), the precise basis for the Court's "integral to the restructuring" conclusion is unstated, and does not necessarily flow from the Court's public rights jurisprudence.

- Before the founding, "[t]he colonists had been subjected to judicial abuses at the hand of the Crown, and the Framers knew the main reasons why: because the King of Great Britain 'made Judges dependent on his Will alone, for the tenure of their offices, and the amount and payment of their salaries.' "Stern, 564 U.S. at 483-84, 131 S.Ct. 2594 (quoting The Declaration of Independence ¶ 11). Since ratification, Article III has served a crucial role in our "system of checks and balances" and "preserve[s] the integrity of judicial decisionmaking[.]" Id. (citation omitted).
- 14 At oral argument, counsel for Voya candidly acknowledged that this is "not the usual case." https://www2.ca3.uscourts.gov/oralargument/audio/18-3210InreMilleniumLabHoldings.mp3 (Oral Arg. at 15:03-07.)
- The parties disagree as to whether the Bankruptcy Court's decision to confirm the plan even implicates *Stern* and Article III. Voya argues that *Stern* deprived the Bankruptcy Court of jurisdiction because the release provisions in the confirmed plan of reorganization constituted a "final judgment" on the merits of Voya's state law claims against Millennium. The Appellees respond that *Stern* is inapplicable here, or at least readily distinguishable, because there is a distinction between a court approving the settlement of claims and adjudicating claims on the merits. According to the Appellees, the Bankruptcy Court only did the former when it approved the plan of reorganization. Our conclusion that the Bankruptcy Court's actions were constitutionally permissible assumes *Stern*'s application. Accordingly, it ultimately is irrelevant to our decision whether or not the Bankruptcy Court issued a "final judgment" on Voya's underlying claims against Millennium, and we do not address that dispute.
- One of the benefits of bankruptcy is its ability "to aid the unfortunate debtor by giving him a fresh start in life[.]" Stellwagen v. Clum, 245 U.S. 605, 617, 38 S.Ct. 215, 62 L.Ed. 507 (1918); see In re Trump Entm't Resorts, 810 F.3d 161, 173-74 (3d Cir. 2016) ("A Chapter 11 reorganization provides a debtor with an opportunity to reduce or extend its debts so its business can achieve longterm viability, for instance, by generating profits which will compensate creditors for some or all of any losses resulting from the bankruptcy."). Equitable mootness allows that benefit to be realized by, among other things, encouraging an end to costly and protracted litigation based on arguable blemishes in a reorganization plan. Cf. In re Tribune, 799 F.3d at 288-89 (Ambro, J., concurring) ("Without equitable mootness, any dissenting creditor with a plausible (or even not-so-plausible) sounding argument against plan confirmation could effectively hold up emergence

In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (2019)

Bankr. L. Rep. P 83,470

from bankruptcy for years (or until such time as other constituents decide to pay the dissenter sufficient settlement consideration to drop the appeal), a most costly proposition.").

- MLH and TA are named as defendants only as to the restitution count. But defendants on all counts are alleged to be close affiliates of MLH and TA. Importantly, defendant TA Associates Management is alleged to control TA, and MLH is alleged to be the effective alter ego of defendant James Slattery. All counts in the complaint are directed against TA Associates Management, Slattery, or both.
- Voya tries to distinguish *In re Tribune* by arguing that the appellant there sought to scuttle the settlement provisions in their entirety, unlike here. But eliminating the release provisions as to Voya would have the same effect as eliminating the release provisions in their entirety: the plan would fall apart.
 - Voya also points us to several other decisions it views as demonstrating that we have "found bankruptcy appeals not to be equitably moot where, as here, a party merely seeks revival of discrete released claims that would not otherwise upset a confirmed plan." (Opening Br. at 51.) The cases it highlights, however, unlike the matter now before us, all involved release provisions that were not central to the plans at issue. See In re Semcrude, 728 F.3d at 324 (holding that a case was not equitably moot because, among other things, granting the requested relief "would [not] upset the [settlement] or ... cause the remainder of the plan to collapse" and the amounts involved in the suit would not "destabilize the financial basis of the settlement"); In re PWS Holding Corp., 228 F.3d 224, 236 (3d Cir. 2000) (rejecting an equitable mootness argument where "[t]he releases (or some of the releases) could be stricken from the plan without undoing other portions of it"); In re Continental Airlines, 203 F.3d at 210 (rejecting an equitable mootness challenge because, among other things, "[n]o evidence or arguments [were] presented that Plaintiffs' appeal, if successful, would necessitate the reversal or unraveling of the entire plan of reorganization").
- Voya says that that course of action would not be inequitable because it did not receive any consideration for releasing its claims; that the plan gave MLH and TA the right to insist that plan consummation be delayed until all appeals were exhausted, and they instead assumed the risk of an adverse ruling; that, "prior to the bankruptcy, [MLH and TA] were willing to make the same \$325 million contribution in the context of an out-of-court restructuring, even if they did not receive releases from non-consenting Lenders holding up to \$50 million (subject to increase) of aggregate principal term loan balance" (Reply Br. at 9); that MLH and TA attempted to leverage Millennium's distress to obtain the release provisions; and that MLH and TA were aware at the time they obtained the release provisions that our precedents regarding such provisions were unclear.
- Nothing in our opinion should be read to imply that review of reorganization plans involving third-party releases will always or even often be barred as equitably moot and therefore effectively unreviewable. Again, our holding today is specific and limited to the particular facts of this case.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

KeyCite Yellow Flag - Negative Treatment
Disagreed With by In re Purdue Pharma L.P., Bankr.S.D.N.Y., September 17,

584 F.3d 229 United States Court of Appeals, Fifth Circuit.

In the Matter of: THE PACIFIC LUMBER CO.; Scotia Pacific Company, LLC, Debtors. Bank of New York Trust Company, NA, as Indenture Trustee for the Timber Notes; Angelo Gordon & Co., LP, Aurelius Capital Management, LP, and Davidson Kempner Capital Management, LLC; Scotia Pacific Company, LLC; CSG Investments; Scotia Redwood Foundation, Inc., Appellants,

V.

Official Unsecured Creditors' Committee;
Official Unsecured Creditors' Committee
Appellee, Marathon Structured Finance
Fund, LP; Mendocino Redwood
Company, LLC; The Pacific Lumber
Co.; United States Justice Department;
California State Agencies, Appellees.

No. 08–40746. | Sept. 29, 2009.

Synopsis

Background: In the Chapter 11 case of six affiliated entities involved in the growing, harvesting, and processing of redwood timber in Humboldt County, California, following the bankruptcy court's termination of debtors' exclusivity period, two competing plans were proposed, one by indenture trustee and the other by secured creditor and one of debtor's competitors. The United States Bankruptcy Court for the Southern District of Texas, Hayden W. Head, Jr., Chief Judge, confirmed the modified reorganization plan proposed by secured creditor and competitor, denied confirmation of indenture trustee's plan, and subsequently granted a motion by indenture trustee and certain noteholders to certify appeal directly to the Court of Appeals, but denied

their motion for a stay pending appeal. In brief interval between confirmation and oral argument before the Court of Appeals, plan was substantially consummated, and secured creditor and competitor, as plan proponents and owners of reorganized debtors, joined by the United States and the State of California, moved to dismiss appeal as equitably moot.

Holdings: The Court of Appeals, Edith H. Jones, Chief Judge, held that:

- [1] equitable mootness did not bar review of issues raised on appeal concerning the treatment of noteholders' secured claims;
- [2] the reorganization plan constituted a "sale" of assets;
- [3] although the reorganization plan involved a "sale" of noteholders' collateral, the plan could be confirmed as "fair and equitable" even if it did not offer noteholders an opportunity to credit bid for their collateral, if it offered them the realization of the "indubitable equivalent" of their allowed secured claims;
- [4] in paying noteholders \$513.6 million in cash, the plan paid them the indubitable equivalent of their claims;
- [5] the plan did not effect a substantive consolidation;
- [6] equitable mootness did not bar re-evaluation of whether noteholders' administrative priority claim was correctly calculated;
- [7] equitable mootness barred review of noteholders' impairment and classification contentions;
- [8] equitable mootness barred review of noteholders' unfair discrimination claim;
- [9] equitable mootness did not bar review of plan's release clauses insulating multiple parties from liability; and
- [10] except with respect to the creditors committee and its members, the non-debtor releases had to be stricken.

Affirmed in part, reversed in part, and remanded.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

West Headnotes (44)

[1] Bankruptcy 🧽 Moot questions

"Equitable mootness," which has evolved in bankruptcy appeals to constrain appellate review, and potential reversal, of orders confirming reorganization plans, is a kind of appellate abstention that favors the finality of reorganizations and protects the interrelated multi-party expectations on which they rest.

8 Cases that cite this headnote

[2] Federal Courts • Right to Decline Jurisdiction: Abstention

Federal courts have a virtually unflagging obligation to exercise the jurisdiction conferred on them.

1 Cases that cite this headnote

[3] Bankruptcy 🧽 Decisions Reviewable

Although the Bankruptcy Code forbids appellate review of certain un-stayed orders and restricts post-confirmation plan modifications, it does not expressly limit appellate review of plan confirmation orders. 11 U.S.C.A. §§ 363(m), 364(e), 1127.

4 Cases that cite this headnote

[4] Federal Courts • Inception and duration of dispute; recurrence; "capable of repetition yet evading review"

Article III mootness, a doctrine of constitutional origin, prevents adjudication when cases are no longer "live." U.S.C.A. Const. Art. 3, § 1 et seq.

1 Cases that cite this headnote

[5] Bankruptcy 🐆 Moot questions

Whereas Article III mootness concerns arise when a judicial ruling would have no effect, equitable mootness applies when a judicial ruling might have too much effect on the parties to a confirmed reorganization. U.S.C.A. Const. Art. 3, § 1 et seq.

6 Cases that cite this headnote

[6] Bankruptcy • Moot questions

Doctrine of equitable mootness is rooted in the court's attempt to strike the proper balance between the equitable considerations of finality and good faith reliance on a judgment and competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting him.

5 Cases that cite this headnote

[7] Bankruptcy • Moot questions

In determining whether the doctrine of equitable mootness bars review of a plan confirmation order, courts consider (1) whether a stay was obtained, (2) whether the plan has been "substantially consummated," and (3) whether the relief requested would affect either the rights of parties not before the court or the success of the plan.

7 Cases that cite this headnote

[8] Bankruptcy • Moot questions

Appellate cases generally apply equitable mootness with a scalpel rather than an axe.

7 Cases that cite this headnote

[9] Bankruptcy 🕪 Moot questions

Equitable mootness applies to specific claims, not entire appeals.

11 Cases that cite this headnote

[10] Bankruptcy 🧽 Moot questions

In exercising its discretionary power to dismiss an appeal on mootness grounds, a court cannot avoid its obligation to scrutinize each individual claim, testing the feasibility of granting the relief against its potential impact on the reorganization scheme as a whole.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

4 Cases that cite this headnote

[11] Bankruptcy & Court of Appeals

Twin purposes of the statutory provision for certification of bankruptcy appeals directly to the Courts of Appeals were to expedite appeals in significant cases and to generate binding appellate precedent in bankruptcy, whose caselaw has been plagued by indeterminacy. 28 U.S.C.A. § 158(d)(2).

3 Cases that cite this headnote

[12] Bankruptcy 🧽 Moot questions

Plan consummation may be dispositive of the question of the equitable mootness of an appeal.

4 Cases that cite this headnote

[13] Bankruptcy 🌦 Moot questions

Under the Bankruptcy Code, "consummation" of a Chapter 11 plan includes transferring all or substantially all of the property covered by the plan, the assumption of business by the debtors' successors, and the commencement of plan distributions. 11 U.S.C.A. § 1141.

2 Cases that cite this headnote

[14] Bankruptcy 🧽 Court of Appeals

Bankruptcy court's rationale for certification of the appeal of its plan confirmation order directly to the Court of Appeals was sufficient; the court, *inter alia*, emphasized the economic calamity facing Chapter 11 debtors, affiliated entities involved in the growing, harvesting, and processing of redwood timber, the court doubted the feasibility of any alternate plan, given the complex and constrictive regulatory environment in which redwood logging existed, and the court found that a direct appeal would materially advance the progress of debtors' cases. 28 U.S.C.A. § 158(d)(2).

[15] Bankruptcy & Court of Appeals

Novel issues raised in the confirmation process, including court's authorization of cramdown of secured debt premised solely on its judicial valuation of a 200,000-acre redwood forest and its denial of noteholders' right to credit bid their debt against the value of the collateral, provided an alternative basis for the bankruptcy court's certification of the appeal of its plan confirmation order directly to the Court of Appeals. 28 U.S.C.A. § 158(d)(2).

[16] Bankruptcy — Moot questions

Equitable mootness did not bar review of issues raised on appeal of bankruptcy court's plan confirmation order concerning the treatment of noteholders' secured claims, despite substantial consummation of debtors' Chapter 11 plan; noteholders' property rights were protected by the takings and due process clauses of the Constitution, over \$500 million in cash had been escrowed to pay noteholders and this money would revert to some other use if the appellate court were to reverse the bankruptcy court's decision, thus affecting the expectations of third parties, adverse appellate consequences were foreseeable to appellees, and complexity of cramdown cried out for appellate review. U.S.C.A. Const.Amend. 5; 11 U.S.C.A. § 1129(a, b).

3 Cases that cite this headnote

[17] Federal Courts 🧽 Property in General

Federal courts should proceed with caution before declining appellate review of the adjudication of property rights under a judgecreated abstention doctrine.

2 Cases that cite this headnote

[18] Bankruptcy — Moot questions

Equitable mootness should protect legitimate expectations of parties to bankruptcy cases but should not be a shield for sharp or unauthorized practices.

3 Cases that cite this headnote

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

[19] Bankruptcy 🧽 Preservation of priority

Bankruptcy Code requires a reorganization plan either to rest on the agreement of each class of creditors or to protect creditor classes according to the absolute priority rule, which enforces a strict hierarchy of their rights defined by state and federal law. 11 U.S.C.A. § 1129(b).

[20] Bankruptcy - Preservation of priority

Absolute priority rule, which has long been a feature of American bankruptcy law, is codified in the standard that a Chapter 11 plan be fair and equitable, with respect to each class of claims of interest that is impaired under, and has not accepted, the plan. 11 U.S.C.A. § 1129(b).

4 Cases that cite this headnote

[21] Bankruptcy - Preservation of priority

"Absolute priority rule" provides that a plan of reorganization may not allocate any property whatsoever to any junior class on account of their interests or claims in a debtor unless such senior classes receive property equal in value to the full amount of their allowed claims. 11 U.S.C.A. § 1129(b).

1 Cases that cite this headnote

[22] Bankruptcy - Preservation of priority Bankruptcy - Fairness and Equity; "Cram

Bankruptcy 🐆 Fairness and Equity; "Cra Down."

Absolute priority rule and the fair and equitable standard must both be satisfied before a court may "cram down" a reorganization plan over the objection of a dissenting creditor class. 11 U.S.C.A. § 1129(b).

1 Cases that cite this headnote

[23] Bankruptcy Fairness and Equity; "Cram Down."

To be fair and equitable with respect to a dissenting class, a Chapter 11 plan must

"include" certain requirements set forth in the Bankruptcy Code. 11 U.S.C.A. § 1129(b)(2)(A).

1 Cases that cite this headnote

[24] Bankruptcy 🧽 Sale or liquidation

Chapter 11 debtors' reorganization plan constituted a "sale" of assets, for confirmation purposes; debtor's competitor joined with debtor's creditor to offer cash and convert debt into equity in return for taking over two of the debtor entities, new entities wholly owned by competitor and creditor received title to the assets in exchange for this purchase, and fact that transaction was complex did not fundamentally alter that it involved a sale of noteholders' collateral. 11 U.S.C.A. § 1129(b)(2)(A)(ii).

4 Cases that cite this headnote

[25] Bankruptcy - Secured creditors, protection of

Although Chapter 11 debtors' reorganization plan involved a "sale" of noteholders' collateral, the plan could be confirmed as "fair and equitable" even if it did not offer noteholders an opportunity to credit bid for their collateral, if it offered them the realization of the "indubitable equivalent" of their allowed secured claims. 11 U.S.C.A. §§ 1123(a)(5)(B, D), 1129(b)(2)(A)(ii, iii).

11 Cases that cite this headnote

[26] Bankruptcy - Secured creditors, protection of

Even a Chapter 11 plan compliant with the three alternative minimum standards for a plan to be fair and equitable with respect to a dissenting class of secured creditors is not necessarily fair and equitable. 11 U.S.C.A. § 1129(b)(2)(A).

4 Cases that cite this headnote

[27] Bankruptcy Secured creditors, protection of

In paying noteholders \$513.6 million in cash, Chapter 11 debtors' reorganization plan paid

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

them the indubitable equivalent of their secured claims and, thus, satisfied the Bankruptcy Code's "fair and equitable" standard for confirmation; although the bankruptcy court valued noteholders' collateral judicially rather than through a public auction, noteholders did not challenge on appeal the court's finding that they would receive more value under the confirmed plan than they could have received in a liquidation, which would have led to a foreclosure auction, nor did they challenge the court's finding that their collateral, some 200 acres of prime redwood timberland, was marketed thoroughly to the public before and during the bankruptcy case, and the court conducted an extensive valuation hearing and heard testimony from eight valuation experts before arriving at a valuation of \$500 million, such that the plan accurately reflected the value of noteholders' collateral. 11 U.S.C.A. §§ 506(a), 1129(b)(2)(A)(iii).

5 Cases that cite this headnote

[28] Bankruptcy • Secured creditors, protection of

Plan proponents could have confirmed a plan that offered a stream of future payments to noteholders yielding the present value of their collateral and then paid off the note one day after the plan was confirmed. 11 U.S.C.A. § 1129(b) (2)(A)(i).

1 Cases that cite this headnote

[29] Bankruptcy 🤛 Secured Claims

Bankruptcy Code does not protect a secured creditor's upside potential; it protects the "allowed secured claim." 11 U.S.C.A. § 506(a).

2 Cases that cite this headnote

[30] Bankruptcy - In general; effect of substantive consolidation

Substantive consolidation is an extreme and unusual remedy.

6 Cases that cite this headnote

[31] Bankruptcy 🧽 Chapter 11 cases

Although "substantive consolidation" may take multiple forms, it usually results in, *inter alia*, pooling the assets of, and claims against, the two entities, satisfying liabilities from the resultant common fund, eliminating intercompany claims, and combining the creditors of the two companies for the purposes of voting on reorganization plans.

5 Cases that cite this headnote

[32] Bankruptcy 🕪 Chapter 11 cases

Chapter 11 debtors' reorganization plan did not effect a substantive consolidation; indenture trustee's allegation that one debtor's claims were paid with the assets of another debtor that were subject to its lien had been rejected by the court, and indenture trustee's only other evidence of substantive consolidation was based on the erroneous contention that the plan commingled inter-company administrative claims.

6 Cases that cite this headnote

[33] Bankruptcy 🤛 Confirmation; Objections

Administrative expenses must be paid in cash at the time of a Chapter 11 plan's confirmation. 11 U.S.C.A. § 1129(a)(9)(A).

[34] Bankruptcy • Moot questions

Despite substantial consummation of Chapter 11 debtors' confirmed reorganization plan, equitable mootness did not bar re-evaluation of whether noteholders' administrative priority claim was correctly calculated; awarding relief on the full \$11 million at stake would not seem to imperil a reorganization involving hundreds of millions of dollars. 11 U.S.C.A. § 1129(a)(9)(A).

1 Cases that cite this headnote

[35] Bankruptcy 🐎 Fairness and Equity; "Cram

Affirmative majority vote, in number and amount, of at least one class of "impaired" claims

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

was necessary to confirm Chapter 11 debtors' cramdown plan. 11 U.S.C.A. § 1129(a)(10).

[36] Bankruptcy 🧽 Classification of claims

Under the Bankruptcy Code, classes must contain "substantially similar" claims, but similar claims can be separated into different classes for "good business reasons." 11 U.S.C.A. § 1122.

1 Cases that cite this headnote

[37] Bankruptcy 🐆 Classification of claims

Facilitating a Chapter 11 plan's confirmation is not a valid justification for separate classification of similar claims. 11 U.S.C.A. § 1122.

2 Cases that cite this headnote

[38] Bankruptcy 🧽 Classification of claims

Thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on reorganization. 11 U.S.C.A. § 1122.

2 Cases that cite this headnote

[39] Bankruptcy 🧽 Moot questions

Noteholders' impairment and classification contentions with respect to Chapter 11 debtors' confirmed reorganization plan were equitably moot where the plan had been substantially consummated, the smaller unsecured creditors, irrespective of their status vis-à-vis the reorganized companies, had received payment for their claims, third-party expectations could not reasonably be undone, and no remedy for noteholders' contentions was practicable other than unwinding the plan, such that noteholders' contentions were not remediable on appeal.

4 Cases that cite this headnote

[40] Bankruptcy & Fairness and Equity; "Cram Down."

Chapter 11 cramdown plan must not discriminate unfairly between claims of equal legal priority. 11 U.S.C.A. § 1129(b)(1).

[41] Bankruptcy • Moot questions

Noteholders' unfair discrimination claim concerning Chapter 11 debtors' confirmed reorganization plan was equitably moot where the plan had been substantially consummated, the smaller unsecured creditors, irrespective of their status vis-à-vis the reorganized companies, had received payment for their claims, third-party expectations could not reasonably be undone, and no remedy for noteholders' contention was practicable other than unwinding the plan, such that noteholders' claim was not remediable on appeal.

5 Cases that cite this headnote

[42] Bankruptcy — Moot questions

Noteholders' claim concerning the legality of non-debtor exculpation and release clause in Chapter 11 debtors' confirmed reorganization plan was not equitably moot, despite substantial consummation of plan; the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the Chapter 11 process.

6 Cases that cite this headnote

[43] Bankruptcy 🕪 Moot questions

Equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process.

1 Cases that cite this headnote

[44] Bankruptcy Settlement, adjustment, or enforcement of claims

Non-debtor releases contained in Chapter 11 debtors' reorganization plan, which released current owners of reorganized debtors, reorganized debtors, and unsecured creditors committee and their personnel from liability, other than for willfulness and gross negligence,

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

related to proposing, implementing, and administering the plan, had to be stricken, except with respect to committee and its members; Bankruptcy Code implied that committee members had qualified immunity for actions within the scope of their duties, but, with respect to the remaining parties, there were no allegations that either of the current owners or their or debtors' officers or directors were jointly liable for any of debtors' prepetition debt, they were not guarantors, sureties, or insurers, and the fresh start provided to debtors was not intended to absolve the released parties from any negligent conduct that occurred during the course of the bankruptcy. 11 U.S.C.A. §§ 524(e), 1103(c).

13 Cases that cite this headnote

Attorneys and Law Firms

*235 Oscar Rey Rodriguez, Toby L. Gerber, Ryan E. Manns, Louis Raymond Strubeck, Jr., Greg Michael Wilkes, Fulbright & Jaworski, L.L.P., Dallas, TX, R. Andrew Black, Zack A. Clement, William Richard Greendyke, Fulbright & Jaworski, L.L.P., Houston, TX, Roy Theodore Englert, Jr. (argued), Robbins, Russell, Englert, Orseck & Untereiner, Washington, DC, for Bank of New York Trust Co., NA, Appellant.

Isaac M. Pachulski, Jeffrey H. Davidson, Eric D. Winston, Stutman, Treister & Glatt, Los Angeles, CA, for Angelo Gordon & Co., LP, Aurelius Capital Management, LP and Davidson, Kempner Capital Management, LLC, Appellants.

Eric J. Fromme, Gibson, Dunn & Crutcher, L.L.P., Irvine, CA, for Scotia Pacific Co., LLC, Appellant.

Murry B. Cohen, Akin, Gump, Strauss, Hauer & Feld, Roger Dale Townsend, Alexander, Dubose & Townsend, LLP, Houston, TX, Joseph Carl Cecere, Charles R. Gibbs, Akin, Gump, Strauss, Hauer & Feld, L.L.P., Dallas, TX, for CSG Investments and Scotia Redwood Foundation, Inc. Appellants.

Maxim Boris Litvak, Pachulski, Stang, Ziehl, Young, Jones, San Francisco, CA, for Official Unsecured Creditors Committee, Appellee.

Steven M. Schwartz, David Neier, Winston & Stawn, New York City, John David Penn, Haynes & Boone, L.L.P., Fort Worth, TX, for Marathon Structured Finance Fund, LP, Appellee.

Allan S. Brilliant (argued), Brian D. Hail, Goodwin Procter, New York City, Frederick Craig Schafrick, Richard Michaels Wyner, Goodwin Procter, Washington, DC, for Mendocino Redwood Co., LLC, Appellee.

Nathaniel Peter Holzer, Jordan, Hyden, Womble, Culbreth & Holzer, Corpus Christi, TX, for Pacific Lumber Co., Appellee.

Bradford T. McLane, James C. Kilbourne, Alan S. Tenenbaum, U.S. Dept. of Justice, Environment & Natural Resources Div., Washington, DC, for U.S. Justice Dept., Appellee.

Paul J. Pascuzzi, Felderstein, Fitzgerald, Willoughby & Pascuzzi, LLP, Sacramento, CA, Michael W. Neville, San Francisco, CA, for California State Agencies, Appellee.

Hugh Matthew McDonald, Thacher, Proffitt & Wood, New York City, for The *236 American Securitization Forum, Amicus Curiae.

Appeal from the United States District Court for the Southern District of Texas.

Before JONES, Chief Judge, and OWEN and SOUTHWICK, Circuit Judges:

Opinion

EDITH H. JONES, Chief Judge:

In this direct appeal from the bankruptcy court, The Bank of New York ("Indenture Trustee") and certain Noteholders challenge the legality of a confirmed Chapter 11 reorganization plan ("plan"). Neither the bankruptcy court nor a motions panel of this court stayed plan confirmation pending appeal. In the brief interval between confirmation and oral argument in this court, the plan was substantially consummated. Plan proponents and current owners of the reorganized debtors, Mendocino Redwood Company ("MRC") and Marathon Structured Finance ("Marathon"), moved to dismiss this appeal as equitably moot due to their intervening actions.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

We hold that equitable mootness does not bar review of issues raised on appeal concerning the treatment of the Noteholders' secured claims; nor does it bar re-evaluation of whether their administrative priority claim was correctly calculated; nor does it bar review of the plan's release clauses insulating multiple parties from liability. Equitable mootness does foreclose our review of issues related to the treatment of impaired and unsecured classes. Finally, we reject the Noteholders' complaints against the plan's payout of cash in full for their allowed secured claim, but we remand the administrative priority claim. We also reverse in part the broad non-debtor releases.

BACKGROUND

Six affiliated entities ("the Debtors") involved in the growing, harvesting, and processing of redwood timber in Humboldt County, California, filed separate Chapter 11 bankruptcy petitions on January 18, 2007, in the Southern District of Texas (a venue not known for its redwood forests). The six petitions were procedurally, but not substantively, consolidated and jointly administered by the bankruptcy court. This appeal concerns the reorganization of the principal debtors, Pacific Lumber Company ("Palco") and Scotia Pacific LLC ("Scopac").²

Palco owned and operated a sawmill, a power plant, and the town of Scotia, California. Marathon held a secured claim against Palco's assets, which ultimately rose to about \$160 million including pre- and post-petition financing. Marathon estimated Palco's assets were worth only \$110 million at the date of filing.

Scopac was a Delaware special purpose entity wholly owned by Palco. In 1998, Palco transferred ownership of more than 200,000 acres of prime redwood timberland ("Timberlands") to Scopac to facilitate the sale of \$867.2 million in notes secured by the Timberlands and Scopac's other assets. Pursuant to an indenture agreement, the Bank of New York represents the Noteholders *237 in the bankruptcy cases, but certain Noteholders retained their own counsel and are named appellants. On the petition date, Scopac owed the Noteholders approximately \$740 million in principal and interest on the notes. Scopac also owed \$36.2 million to Bank of America on a secured line of credit with a right to payment ahead of the Noteholders.

Palco and Scopac maintained separate corporate structures but were an integrated company. One of Scopac's three directors sat on Palco's board, and the companies had the same CEO, CFO, and General Counsel for substantially all of the relevant period. Palco had the sole right to harvest Scopac's timber, which Palco then processed and sold. Scopac was to repay the Noteholders with proceeds from its sales to Palco.

The Timberlands are heavily regulated by federal and state agencies. The U.S. Fish and Wildlife Service, the National Marine Fisheries Service, and the California Department of Fish and Game vigorously administer federal and state endangered species regulations. Any new owner of the Timberlands must obtain Regional Water Quality Control Board permits that regulate waste discharge, clean-up and abatement, and site remediation. The California Department of Forestry and Fire Protection requires a timber harvesting plan covering issues like restocking, mitigating the effects of harvesting and erosion, road maintenance and sustainable yield requirements. Under the Timberlands' conservation plan, a transfer of ownership must run the gamut of preapproval by all of these agencies.

After a year passed without sufficient progress toward a reorganization plan, the bankruptcy court terminated the debtors' exclusivity period (11 U.S.C. § 1121) and allowed the filing of five competing proposed plans. The court approved a joint disclosure statement for the plans and expedited solicitation and voting so that a confirmation hearing could begin in early April 2008. During the extended hearing, the Debtors withdrew their plans, leaving only two. The Indenture Trustee's plan covered the assets of Scopac alone, while that proposed by Marathon and MRC, the latter entity a competitor of Palco, sought to reorganize all of the Debtors.

On June 6, the bankruptcy court held the MRC/Marathon plan confirmable but the Indenture Trustee's plan not confirmable.³ The Indenture Trustee has not appealed the court's rejection of its plan. The MRC/Marathon plan proposed to dissolve all six entities, cancel intercompany debts, and create two new entities, Townco and Newco. Almost all of Palco's assets, including the town of Scotia, California, would be transferred to Townco. The Timberlands and assets of the sawmill would be placed in Newco. MRC and Marathon proposed to contribute \$580 million to Newco to pay claims against Scopac. Marathon would also convert its \$160 million senior secured claim against Palco's assets into equity, giving it full ownership of Townco, a 15% stake in Newco, and a new note for the amount of the sawmill's

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

working capital. MRC would own the other 85% of Newco and would manage and run the company.

*238 The plan created 12 classes, seven of which were eligible to vote, 4 and four of which contained claims against Scopac. Class 5 proposed to pay Bank of America, the sole class member, \$37.6 million, consisting of the principal (\$36.2 million), accrued post-petition interest, unpaid fees, and approximately \$1 million in default interest paid over 12 months, thus impairing the class.⁵ Class 6 proposed to pay the Noteholders' secured claim the value of their collateral and a lien on proceeds from pending unrelated litigation against the state of California, which the parties refer to as the Headwaters Litigation. 6 Class 8 proposed to pay unsecured claims against Scopac by former employees and trade vendors not previously deemed "critical," but these amounts were exposed to ongoing litigation regarding assumption and rejection of executory contracts, thus impairing the class. Class 9 was tailored to pay Scopac's remaining general unsecured claims, consisting of the Noteholders' deficiency claim⁸ for over \$200 million with a recovery estimated as "unknown."

At least one impaired Scopac class had to vote in favor of the plan for it to be confirmable as to Scopac. 11 U.S.C. § 1129(a). Classes 5 and 8 voted for the plan. Class 6 (the Noteholders' secured claim) and Class 9 (the Noteholders' deficiency claim) voted against confirmation. To confirm its plan, MRC/Marathon had to "cram down" the plan on the dissenting classes pursuant to 11 U.S.C. § 1129(b).

A central question for the confirmation cram-down was the value of the Timberlands securing the Noteholders' claim. To this end, the court heard extensive valuation testimony over several days and ultimately valued the Timberlands at "not more than \$510 million." The bankruptcy court concluded that \$510 million was the "indubitable equivalent" of the Noteholders' secured claim on the Timberlands, *see* 11 U.S.C. § 1129(b)(2)(A)(iii), and that MRC/Marathon's plan, after several minor alterations, ¹⁰ otherwise complied with Bankruptcy Code requirements.

*239 Two months earlier, the Indenture Trustee moved for a super-priority administrative expense claim, arguing its collateral diminished in value post-petition. This motion was rejected following hearings in late June and early July. For the first time, the court valued the Noteholders' non-

timberland collateral at \$48.7 million on the petition date. After a deduction for the Bank of America's priming lien and the Indenture Trustee's legal fees, ¹² the remaining value of the Noteholders' non-timberland collateral was \$3.6 million. In total, the MRC/Marathon plan offered the Noteholders \$513.6 million in cash, any payments that might flow to their unsecured deficiency claim, and a retained lien on any Headwaters litigation proceeds.

On July 8, the court confirmed the modified plan and denied confirmation of the Indenture Trustee's plan. The next day, the Indenture Trustee, joined by Scopac and individual Noteholders, moved to stay confirmation of the plan pending appeal, and the Indenture Trustee moved to certify the appeal directly to this court. The bankruptcy court granted the motion to certify but denied the stay pending appeal. A motions panel of this court issued an interlocutory order similarly denying the Indenture Trustee's motion to stay confirmation pending appeal.

The Indenture Trustee asserts on appeal contentions of three types: those challenging the treatment of their security interests; those challenging the plan confirmation procedures; and those relating to other specific plan terms. The issues raised are that the confirmed MRC/Marathon reorganization plan: (1) violates the absolute priority rule by paying junior Palco and Scopac creditors with the Noteholders' collateral; (2) is not "fair and equitable" because the plan sold the Timberlands collateral without providing the Noteholders a right to credit bid; (3) values the Noteholders' collateral too low and by an improper judicial process; (4) creates an illegal substantive consolidation of Scopac and Palco; (5) fails to pay inter-company administrative priority claims in cash; (6) artificially impaired the claim owed to Bank of America and illegally gerrymandered the voting classes of unsecured claims in classes 8 and 9; (7) discriminates unfairly in its treatment of the Noteholders' Class 9 deficiency claim; and (8) includes unauthorized third-party release and exculpation provisions.

On August 21, MRC/Marathon, joined by the United States and the State of California, on the basis of their respective regulatory interests, moved to dismiss this appeal as equitably moot. Because this motion logically precedes considering the merits of the appeal, we consider it first.¹⁴

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

*240 DISCUSSION

A. Equitable Mootness

Appellees contend that this appeal is equitably moot and must be dismissed because no stay pending appeal of confirmation was granted; the plan is substantially consummated; and unwinding it will have an adverse effect on third-parties and will prevent a successful reorganization. *In re UNR Industries Inc.*, 20 F.3d 766, 769 (7th Cir.1994).

[2] [3] [4] [5] "Equitable mootness" has evol in bankruptcy appeals to constrain appellate review, and potential reversal, of orders confirming reorganization plans. Equitable mootness is a kind of appellate abstention that favors the finality of reorganizations and protects the interrelated multi-party expectations on which they rest. See In re Manges, 29 F.3d 1034, 1039 (5th Cir.1994). Despite its apparent virtues, equitable mootness is a judicial anomaly. Federal courts "have a virtually unflagging obligation" to exercise the jurisdiction conferred on them. Colorado River Water Conservation Dist. v. United States, 424 U.S. 800, 817, 96 S.Ct. 1236, 1246, 47 L.Ed.2d 483 (1976). Although the Bankruptcy Code forbids appellate review of certain un-stayed orders¹⁵ and restricts post-confirmation plan modifications, ¹⁶ it does not expressly limit appellate review of plan confirmation orders. Moreover, equitable mootness cannot claim legitimacy based on Article III mootness. The latter doctrine, of constitutional origin, prevents adjudication when cases are no longer "live"; the former abdicates appellate review of very real, continuing controversies. As then-Judge Alito wrote, Article III mootness concerns arise when a judicial ruling would have no effect; equitable mootness applies when a judicial ruling might have too much effect on the parties to a confirmed reorganization. In re Continental Airlines, 91 F.3d 553, 569 (3d Cir.1996) (en banc) (Alito, J., dissenting). See also In re UNR Industries, 20 F.3d 766, 769 (7th Cir.1994) (Easterbrook, J.) (equitable mootness is a misnomer).

[6] [7] Nevertheless, the rationale for equitable mootness is not at issue here. The doctrine is firmly rooted in Fifth Circuit jurisprudence, as this court attempts to "strik[e] the proper balance between the equitable considerations of finality and good faith reliance on a judgment and competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting him." *In re Manges*, 29 F.3d at 1039; *In re Hilal*, 534 F.3d 498, 500 (5th Cir.2008); *In re GWI PCS 1 Inc.*, 230 F.3d 788, 800 & n. 24 (5th Cir.2000); *In re Berryman*

Products, Inc., 159 F.3d 941, 944 (5th Cir.1998). This court accordingly considers "(1) whether a stay was obtained, (2) whether the plan has been 'substantially consummated,' and (3) 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.

[8] It is important to observe that appellate cases generally apply equitable mootness with a scalpel rather than an axe. This court has been especially solicitous of the rights of secured creditors following confirmation. Thus, equitable regretories did not stand in the way of our reversing an order that improperly required *241 a secured lender, as part of a reorganization plan, to reimburse environmental remediation expenses incurred by the debtor. *In re Grimland*, 243 F.3d 228, 232 (5th Cir.2001). In an earlier case, this court reviewed whether the principal secured lender to a debtor received the "indubitable equivalent" of its interest when its lien was modified by the plan. *In re Sun Country Dev., Inc.,* 764 F.2d 406, 409 (5th Cir.1985). This court noted that reversal of the confirmation order would simply require reimposition of the original lien. *Id.* at 407 n. 1.

This court has also conducted appellate review of plan provisions that relieved a bankruptcy trustee from liability following a confirmed plan, and has ordered attorneys to reimburse sums improperly allocated to them from secured creditors. *See In re Hilal*, 534 F.3d at 501; *In re SI Restructuring*, 542 F.3d 131, 136–37 (5th Cir.2008). In neither of those cases had a stay been obtained, and the reorganization plans had been substantially consummated. Each opinion found, however, that there would be no significant adverse consequences to the reorganization from appellate review of the particular issues.

[9] [10] Other courts have carefully weighed the consequences before applying equitable mootness to issues raised on appeal of plan confirmation orders. Notably, they hold that appellate review need not be declined when, because a plan has been substantially consummated, a creditor could not obtain full relief. If the appeal succeeds, the courts say, they may fashion whatever relief is practicable. After all, appellants "would readily accept some fractional recovery that does not impair feasibility or affect parties not before this Court, rather than suffer the mootness of [their] appeal as a whole." *In re Chateaugay Corp.*, 10 F.3d 944, 954 (2d Cir.1993) (citing *MCI Telecommunications Corp. v. Credit Builders of America, Inc.*, 2 F.3d 103, 104 (5th Cir.1993) ("[A] case is not mooted by the fact that an impecunious

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

judgment debtor may lack the means to satisfy a judgment.")) See also In re PWS Holding Corp., 228 F.3d 224, 236–37 (3d Cir.2000). Another caveat is that equitable mootness applies to specific claims, not entire appeals. "In exercising its discretionary power to dismiss an appeal on mootness grounds, a court cannot avoid its obligation to scrutinize each individual claim, testing the feasibility of granting the relief against its potential impact on the reorganization scheme as a whole." In re AOV Industries Inc., 792 F.2d 1140, 1148 (D.C.Cir.1986). 17

[11] To these cautions regarding equitable mootness must finally be added the impact of the new statutory provision for certification of bankruptcy appeals directly to the courts of appeals. 28 U.S.C. § 158(d)(2). The twin purposes of the provision were to expedite appeals in significant cases and to generate binding appellate precedent in bankruptcy, whose *242 caselaw has been plagued by indeterminacy. H.R.Rep. No. 109–31 pt. I, at 148 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 206. Congress's purpose may be thwarted if equitable mootness is used to deprive the appellate court of jurisdiction over a properly certified appeal.

[12] [13] All of these factors bear on the instant appeal Because the bankruptcy court denied a stay pending appeal, this court faced a fait accompli, a plan that was substantially consummated within weeks of confirmation. As we have noted, plan consummation may often be dispositive of the question of equitable mootness. In re Manges, 29 F.3d at 1040 (quoting In re UNR Industries Inc., 20 F.3d at 770 ("A stay not sought, and stay sought and denied, lead equally to the implementation of the plan of reorganization.")). Under the Bankruptcy Code, consummation includes transferring all or substantially all of the property covered by the plan, the assumption of business by the debtors' successors, and the commencement of plan distributions. 11 U.S.C. § 1141; In re Manges, 29 F.3d at 1041, n. 10. Within fewer than sixty days following the confirmation order, Scopac and Palco were dissolved and their assets transferred to new entities, Newco and Townco, now named Humboldt Redwood Company ("HRC") and the town of Scotia, respectively. The new entities raised \$325 million in exit financing secured by HRC and guaranteed by MRC. Creditors other than the Noteholders have been paid over \$50 million. HRC hired new management, changed its management structure, engaged business consultants and leased new office space and a distribution center. HRC has signed new contracts with re-manufacturers and won business from a national home products retailer. The town of Scotia invested in costly capital

improvements. In addition, HRC has successfully navigated the regulatory labyrinth and secured unanimous approval to operate from the state and federal agencies. All of these events created third-party reliance and expectations that would be dislodged if the Noteholders succeed in entirely reversing the confirmation order. *In re Manges*, 29 F.3d at 1043. We will further balance these facts as we analyze the specific issues raised on appeal.

[14] But the incongruity of the bankruptcy court's actions in both denying a stay pending appeal and certifying its orders for direct appeal to this court—requires immediate comment. Facially, the two decisions do not conflict. The court briskly dispatched the legal issues raised by the Noteholders as having no likelihood of success on appeal. It emphasized the economic calamity facing Palco and Scopac. The court doubted the feasibility of any alternate plan, given the complex and constrictive regulatory environment in which redwood logging exists. The court found that a direct appeal would materially advance the progress of the debtors' cases. See 28 U.S.C. § 158(d)(2)(iii). Certification was also driven by the prominence of this case to the citizens of California, of Humboldt County, and of the town of Scotia and by the plan's effect on "one of the nation's most ecologically diverse forests" Based solely on this reasoning, the court's certification decision complements the denial of the stay by speeding the case to the final disposition the court desired. Its rationale for certification is certainly sufficient under 28 U.S.C. § 158(d)(2)(i).

[15] An alternative basis for certification also existed, however, because of the novel issues raised in the confirmation process. The court authorized cramdown of secured debt premised solely on its judicial valuation of a 200,000–acre redwood forest, and it denied the Noteholders' right to credit bid their debt against the value of *243 the collateral. The nature of this cramdown and the refusal to apply § 1129(b)(2)(A)(ii) to authorize a credit bid are unusual, perhaps unprecedented decisions. Such issues and others mentioned later, when considered in the context of reorganizing nearly a billion dollars total debt and over \$700 million of the Noteholders' secured debt, deserved certification and an opportunity for direct appeal. See 28 U.S.C. § 158(d)(2)(ii).

Although the exigencies of the case appeared to demand prompt action, simply denying a stay seems to have been, and often will be, too simplistic a response. A plan may be designed to take effect, as it was here, after a lapse of

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

sufficient time to initiate appellate review. A supersedeas bond may be tailored to the scope of the appeal. An appeal may be expedited. As with all facets of bankruptcy practice, myriad possibilities exist. Thus, substantial legal issues can and ought to be preserved for review. *Compare In re First South Savings Ass'n*, 820 F.2d 700, 709 & n. 10 (5th Cir.1987).

B. The Indenture Trustee's Claims

1. Issues Pertaining to Secured Claim.

[16] Three of the Indenture Trustee's issues challenge what the Noteholders received for their collateral—approximately \$513 million in cash—pursuant to the bankruptcy court's determination of the value of the Timberlands. According to the Noteholders, the plan violates their rights imbedded in the absolute priority rule and the fair and equitable standard governing the treatment of claims in chapter 11 reorganizations. See generally 11 U.S.C. § 1129(a), (b). Alternatively, the Noteholders challenge the methodology and amount reached in the court's valuation of the Timberlands.

[17] We hold these issues justiciable notwithstanding the tug of equitable mootness. Secured credit represents property rights that ultimately find a minimum level of protection in the takings and due process clauses of the Constitution. 18 The Bankruptcy Code's reorganization provisions in fact "preserve the essence" of the boundaries of secured creditors' rights laid out in constitutional cases. See Kenneth N. Klee, Bankruptcy and the Supreme Court 139 (2008). Federal courts should proceed with caution before declining appellate review of the adjudication of these rights under a judgecreated abstention doctrine. Moreover, while we have found no case that applied equitable mootness to decline review of the treatment of a secured creditor's claim, at least two cases in this court have ruled on such appeals despite plan proponents' pleas for equitable mootness. In re Grimland, 243 F.3d 228, 232 (5th Cir.2001); In re Sun Country Dev. Inc., 764 F.2d 406, 409 (5th Cir.1985). Only a year before *Manges* issued, we reviewed all issues pertaining to a cramdown reorganization plan without any concerns being voiced about equitable mootness. Matter of Briscoe Enterp. Ltd., II, 994 F.2d 1160 (5th Cir.1993).

[18] Nor is it inconsistent with *In re Manges* to review the Noteholders' challenges regarding the treatment of their secured claims. Despite the substantial consummation of the MRC/Marathon plan, or rather, because of it, over \$500 million in cash was escrowed to pay the Noteholders. *244

If we were to reverse the bankruptcy court's decision, the cash would revert to some other use for the benefit of the reorganized company. We need not invent hypotheticals to suggest that the expectations of third parties other than MRC/Marathon could largely be preserved despite a decision reinstating or re-evaluating the Noteholders' liens. Alternatively, some other, more limited form of relief might be afforded the Noteholders. See In re Chateaugay, 10 F.3d at 954. That there might be adverse consequences to MRC/ Marathon is not only a natural result of any ordinary appeal -one side goes away disappointed-but adverse appellate consequences were foreseeable to them as sophisticated investors who opted to press the limits of bankruptcy confirmation and valuation rules. 19 Finally, the complexity of cramdown often cries out for appellate review, and this "should encourage the debtor to bargain with creditors to gain acceptance of a plan in the majority of cases." Kenneth N. Klee, All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code, 53 Am. Bankr.L.J. 133, 171 (1979).

Turning to the merits, the [19] [20] [21] [22] Bankruptcy Code requires a reorganization plan either to rest on the agreement of each class of creditors or to protect creditor classes according to the absolute priority rule, which enforces a strict hierarchy of their rights defined by state and federal law. The absolute priority rule has long been a feature of American bankruptcy law. It is codified in the standard that a plan be "fair and equitable, with respect to each class of claims of interest that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b).²⁰ The absolute priority rule and the fair and equitable standard must both be satisfied before a court may "cram down" a reorganization plan over the objection of a dissenting creditor class.

The Noteholders initially contend that the MRC/Marathon plan violates absolute priority by directing some of the capital injected by MRC and Marathon to pay claims junior to the Noteholders' secured claim. This argument has two components. The first is rooted in valuation. If the bankruptcy court's valuation of the Noteholders' collateral aligned with their valuation, and if the plan paid them that amount, the Noteholders would not complain. It is only because they perceive a valuation shortfall that they contend more of the purchase price of the assets should have been paid for their collateral and was improperly used to pay junior creditors. This valuation issue will be addressed further below.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

*245 [23] The second component of the Noteholders' absolute priority objection is based on the fair and equitable standard as applied to secured creditors. To be fair and equitable with respect to a dissenting class, a plan must "include" certain requirements. 11 U.S.C. § 1129(b)(2) (A). Three minimum alternatives are provided for secured creditors. Under the first alternative, the holders may retain their liens accompanied by the right to receive deferred cash payments having a present value equal to the value of the collateral. 11 U.S.C. § 1129(b)(2)(A)(i) ("Clause (i)"). Second, the secured property may be sold free and clear of liens, with the liens attaching to the proceeds, as long as the creditor has the right to credit bid pursuant to 11 U.S.C. § 363(k). 11 U.S.C. § 1129(b)(2)(A)(ii) ("Clause (ii)"). Third, the plan may allow for the "realization by such holders of the indubitable equivalent of such claims." 11 U.S.C. § 1129(b) (2)(A)(iii) ("Clause (iii)").

[25] In this case, the bankruptcy court held that Clause (ii), governing sales free and clear, is inapplicable because the reorganization plan constitutes a "transfer" rather than a "sale" of assets. See 11 U.S.C. § 1123(a)(5)(B) and (D). We agree with the Noteholders that this ruling was wrong. MRC, a competitor of Palco, joined with Palco's creditor Marathon to offer cash and convert debt into equity in return for taking over both Palco and Scopac. New entities wholly owned by MRC and Marathon received title to the assets in exchange for this purchase. That the transaction is complex does not fundamentally alter that it involved a "sale" of the Noteholders' collateral. See Black's Law Dictionary 1337 (7th ed.1999). Section 1123(a)(5), cited by the court, lists "transfers" and "sales" among various devices a debtor may employ to accomplish reorganization, and "transfer" is defined broadly in 11 U.S.C. § 101(54). The terms used in these provisions are descriptive and have no independent legal significance. Further, as the Noteholders point out, every sale of property involves a transfer, but not every transfer is a sale. Here, a sale occurred. Clause (ii) could have applied.

The Noteholders, however, must do more than show that Clause (ii) theoretically applied to this transaction. They have to demonstrate its exclusive applicability. They observe that Clause (ii) alone concerns sales of collateral under a plan and specifically allows the dissenting creditor to credit bid for the collateral. Consequently, they contend, Clause (ii) should prevail under the canon of statutory construction that the more specific provision controls over the general indubitable equivalent alternative of Clause (iii). Allowing

sales of collateral free and clear of liens under Clause (iii) would also, in their view, render Clause (ii) superfluous.

[26] For several reasons, the Noteholders' arguments cannot be accepted. This court has subscribed to the obvious proposition that because the three subsections of $\S 1129(b)(2)$ (A) are joined by the disjunctive "or," they are alternatives. Briscoe, 994 F.2d at 1168. In Briscoe, the court added that it had "not transformed the 'or' in 1129(b)(2)(A) into an 'and.' "Id. As alternatives, these provisions are not even exhaustive. The introduction to § 1129(b)(2) states that the "condition that a plan be fair and equitable includes the following requirements" (emphasis added). The Bankruptcy Code specifies that the term "includes" "is not limiting." 11 U.S.C. § 102(3). Even a plan compliant with these alternative minimum standards is not necessarily fair and equitable. Matter of Sandy Ridge Dev. Corp., 881 F.2d 1346, 1352 reh'g denied, 889 F.2d 663 (5th Cir.1989). The non-exhaustive nature of the three subsections is inconsistent with *246 treating them as compartmentalized alternatives. Finally, Clause (iii) does not render Clause (ii) superfluous facially or as applied to the MRC/Marathon plan. Although a credit bid option might render Clause (ii) imperative in some cases, it is unnecessary here because the plan offered a cash payment to the Noteholders. Clause (iii) thus affords a distinct basis for confirming a plan if it offered the Noteholders the "realization ... of the indubitable equivalent of such claims."

[27] The question then becomes how to define Clause (iii) and whether the MRC/Marathon plan satisfies the definition. To begin, "such claims" are the creditors' allowed secured claims, which, according to the statute, equal the value of the collateral. 11 U.S.C. § 506(a); see also, Matter of Sandy Ridge, 881 F.2d at 1350.²¹ What measures constitute the indubitable equivalent of the value of the Noteholders' collateral are rarely explained in caselaw, because most contested reorganization plans follow familiar paths outlined in Clauses (i) and (ii). One eminent author concluded from the legislative history that

Abandonment of the collateral to the class would satisfy [indubitable equivalent], as would a replacement lien on similar collateral. But present cash payments to the class less than the amount of the allowed secured claims would not satisfy the standard. Nor are unsecured notes or equity securities sufficient to constitute the "indubitable equivalent" of secured claims.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

Kenneth N. Klee, All You Ever Wanted to Know About Cram Down under the Bankruptcy Code, *supra* at 156. *See also Matter of Sandy Ridge*, 881 F.2d 1352 (affirming "dirt for debt" plan offering return of collateral in satisfaction of lender's secured claim as a possible Clause (iii) plan). Likewise insufficient is a debtor's offer to repay the balance of a secured debt in a balloon payment ten years after confirmation with interim interest payments but no requirements to protect the collateral. *In re Murel Holding Co.*, 75 F.2d 941, 942 (2d Cir.1935). Judge Learned Hand coined the term "indubitable equivalent" in explaining why the reorganization plan in *Murel* could not be confirmed over the secured creditors' objection:

[A] creditor who fears the safety of his principal will scarcely be content with [interest payments alone]; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that ... unless by a substitute of the most indubitable equivalence.

Id. See also In re Sun Country, 764 F.2d at 409 (ruling that 21 notes secured by 21 different lots was indubitable equivalent of value lien on the entire parcel).

Based on these examples, Congress did not adopt indubitable equivalent as a capacious but empty semantic vessel. Quite the contrary, these examples focus on what is really at stake in secured credit: repayment of principal and the time value of money. Clauses (i) and (ii) explicitly protect repayment to the extent of the secured creditors' collateral value and the time value compensating for the risk and delay of repayment. Indubitable equivalent is therefore no less demanding a standard than its companions. The MRC/Marathon Clause (iii) plan obviated both of the *247 bases for protection by offering cash allegedly equal to the value of the Timberlands. No need arose to afford collateral or compensate for delay in repayment. Whatever uncertainties exist about indubitable equivalent, paying off secured creditors in cash can hardly be improper if the plan accurately reflected the value of the Noteholders' collateral.

[28] [29] The Noteholders nevertheless protest that the plan, by depriving them of the right to credit bid and presumably foreclose on the Timberlands, failed to afford them the indubitable equivalent because they forfeited the possibility of later increases in the collateral's value. The Bankruptcy Code, however, does not protect a secured creditor's upside potential; it protects the "allowed secured claim." If a creditor were over-secured, it could not demand to keep its collateral rather than be paid in full simply to protect the "upside potential." Further, indubitable equivalence

does not require more protection than is afforded by the preceding clauses in § 1129(b)(2)(A). In this connection, MRC/Marathon could have confirmed a plan under Clause (i) that offered a stream of future payments to the Noteholders yielding the present value of their collateral and then paid off the note one day after the plan was confirmed. Just as the Noteholders would have no statutory complaint against that treatment, ²² so they cannot support a statutory argument that they are entitled to better treatment under Clause (iii).

The Noteholders' claimed right to credit bid embraces their additional disagreement with the bankruptcy court's decision to value the Timberlands judicially rather than through a public auction. They attempt to extrapolate support from the Supreme Court's decision in Bank of America Nat'l Trust & Savings Ass'n v. 203 N. LaSalle Street P'ship, 526 U.S. 434, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999). In LaSalle Street, the Court held the absolute priority rule was violated when a bankruptcy court confirmed a plan permitting a debtor's shareholders to retain control "on account of" "new value" capital contributions to the debtor. The Court held that "some form of market valuation" is necessary before former shareholders may circumvent the absolute priority rule. We agree that LaSalle Street encourages bankruptcy courts to be wary of the shortcomings of judicial valuation proceedings, but the case is factually distinguishable from this one.

We need not take a position on LaSalle Street, however, because the procedural history of this case contradicts the Noteholders' position. They have not challenged on appeal the court's finding that they will receive more value under the MRC/Marathon plan than they could have received in a liquidation, which would have led to a foreclosure auction. They do not challenge the court's finding that the Timberlands were marketed thoroughly to the public before and during the bankruptcy case. The Noteholders complain that adequate marketing was impossible because of the speed of the confirmation process and the court's decision to lift exclusivity only for the sake of specific parties, yet they assented to both orders. Six months elapsed between the lifting of exclusivity and confirmation of the plan, while the confirmation hearing itself spanned three *248 months. The fact is that many entities felt called to express an interest in purchasing the Timberlands, but none was willing to submit a firm offer. The Noteholders have not established a predicate for their auction complaint—either by preserving a timely objection to the court's procedures or by a showing of prejudice.

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

The final stage in the Noteholders' objection to the treatment of their secured claim is the court's valuation decision, which yielded them net cash of approximately \$513.6 million. Their briefing, oddly, dwells more on the alleged inherent shortcomings of the valuation process than on the bankruptcy court's final result. With the exception of collateral that may have been left out of the valuation, the court's result is not clearly wrong. The valuation hearing was extensive. The court heard testimony from eight valuation experts. Three of these experts provided testimony on the characteristics of the Timberlands, and four provided ultimate estimates of the value of the approximately 200,000-acre stand of timberland.²³ MRC/Marathon's expert is a timberland appraiser with extensive experience. Using two standard appraisal methods, the income approach and the comparable sales approach, he testified the Timberlands were worth \$430 million or \$425 million, respectively. Given the expert's experience and his method, the bankruptcy court gave his testimony significant weight.

The Indenture Trustee tendered two valuation experts. The first valued the timberlands at \$605 million and the second at \$575–\$605 million. The court found the first analysis had significant flaws including the chosen start date, the valuation method, the failure to account for recent declines in redwood and Douglas fir prices, and the lack of specificity in the analysis. The second appraisal was also suspect. The witness's testimony contradicted earlier testimony offered by another expert at his firm. The court also found the expert's firm prepared the report for him and essentially ordered him to testify. Further, when questioned, the expert undermined his analytical methodology by conceding that he had never seen preliminary bids employed in a valuation analysis other than this one.

The Indenture Trustee's appeal relies heavily on several third-party offers to purchase the Timberlands for more than \$510 million. This is persuasive market evidence, it claims, that the bankruptcy court's valuation was clearly too low. The bankruptcy court found, however, that these bids were either unreliable or too tentative to consider. By the Indenture Trustee's own admission, it had been soliciting offers for the Timberlands "all along." That no firm bid was submitted during this period shows that the Indenture Trustee's proposed valuation was too high. Scopac also tendered an expert who valued the Timberlands at approximately \$940 million, but the court discounted this appraisal because the pricing data and assumptions on price increase were too high and overly optimistic.

Ultimately, the court adjusted MRC/Marathon's appraisal upward and the Indenture Trustee's downward and arrived at a valuation of \$510 million. This represents a reasonable accommodation of complex and sometimes contradictory testimony. The Noteholders have made little effort to prove a clear error. What we have said before remains true: "Although we recognize that valuation is not an exact science, it remains an integral part of the *249 bankruptcy process." *Matter of Sandy Ridge*, 881 F.2d at 1354.²⁴

We conclude that the MRC/Marathon plan, insofar as it paid the Noteholders the allowed amount of their secured claim, did not violate the absolute priority rule, was fair and equitable, satisfies 11 U.S.C. § 1129(b)(2)(A)(iii), and yielded a fair value of the Noteholders' secured claim.

2. De Facto Substantive Consolidation

[30] Although the bankruptcy court found that the MRC/Marathon plan does not effect a substantive consolidation, the Indenture Trustee challenges this holding. Substantive consolidation is an "extreme and unusual remedy." In re Gandy, 299 F.3d 489, 499 (5th Cir.2002). Substantive consolidation may take multiple forms, but "it usually results in, inter alia, pooling the assets of, and claims against, the two entities; satisfying liabilities from the resultant common fund; eliminating intercompany claims; and combining the creditors of the two companies for the purposes of voting on reorganization plans." In re The Babcock and Wilcox Co., 250 F.3d 955, 958-59 n. 5 (5th Cir.2001) (quoting In re Augie/Restivo Baking Co., Ltd., 860 F.2d 515, 518 (2d Cir.1988)). There are some justifications for substantive consolidation, see 2 Lawrence P. King et al., Collier on Bankruptcy § 105.09[2] (15th ed. rev.2009), but here, the Indenture Trustee claims the confirmed plan resulted in substantive consolidation without the bankruptcy court's providing any justification or following the proper procedures. See In re The Babcock and Wilcox Co., 250 F.3d at 958 (characterizing de facto substantive consolidation).

[32] We are mindful of the Indenture Trustee's concerns, especially in a case involving securitized lending through a bankruptcy-remote special purpose entity like Scopac. ²⁵ The Indenture Trustee's argument fails, however, to prove that substantive consolidation occurred here. Its allegations that unsecured Palco claims were paid with Scopac assets subject to its *250 lien have been addressed and rejected above. Its only other evidence of substantive consolidation is based

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

on the erroneous contention that the plan commingled intercompany administrative claims. Because these contentions are easily disposed of, we need not consider whether this claim is equitably moot.

3. Unpaid Inter-company Administrative Priority Claim

[33] [34] During the bankruptcy proceedings, the Debtors agreed that Scopac would hold logs for Palco at their log deck, subject to certain conditions, because Palco did not have the cash to keep purchasing logs. The Indenture Trustee argues that, on the confirmation date, Scopac had an approximately \$11 million post-petition administrative claim against Palco for unpaid log deliveries. Under 11 U.S.C. § 1129(a)(9)(A), this administrative expense must be paid in cash at the time of confirmation. Because awarding relief on the full \$11 million would seem not to imperil a reorganization involving hundreds of millions of dollars, the bankruptcy court would be able to award effective relief either with an appropriate lien in the Noteholders' favor or a cash payment. See In re Chateaugay, 10 F.3d at 954 (ruling that the possibility of fractional recovery was sufficient to avoid finding the appeal of a confirmation plan entirely moot). This claim is not equitably moot.

The Indenture Trustee first asserts that certain plan provisions impermissibly merged the treatment of pre—and post-petition claims and failed to promise full payment of all administrative claims, including the \$11.1 million account receivable for the log inventory. This is incorrect; the plan provisions facially comply with the Bankruptcy Code, as the court concluded.

It is not certain, however, whether the court accounted for the \$11.1 million account receivable when it valued the Noteholders' post-petition collateral. The ultimate \$513.6 million valuation reflects the Noteholders' security interest in the Timberlands and cash and cash equivalents as of the petition date. Contrary to the assertion of MRC/Marathon, the exhibit the court used to arrive at the value of Scopac's cash on hand on the petition date itemizes the \$11.1 million in net accounts receivable Scopac had in May 2008 and segregates that amount from the court's starting point of \$48.7 million. How much of the \$11.1 million receivable consists of unpaid log deliveries is unstated, but a note to this exhibit indicates that accounts receivable are no longer being collected from Palco. The court may have made a mathematical error and deprived the Noteholders of this post-petition administrative priority claim.

Therefore, we remand for a determination of the value of this administrative priority claim and the extent to which effective relief is available.

4. Artificial Impairment of Class 5 Claim and Gerrymandering of Unsecured Claims in Classes 8 and 9 [35] The Noteholders raise significant objections to the plan's treatment of the Bank of America's claim in Class 5 and its division of unsecured claims with equal legal status into two voting classes, 8 and 9. An affirmative majority vote, in number and amount, of at least one class of "impaired" claims was necessary to confirm a cramdown plan. 11 U.S.C. § 1129(a)(10).

The Noteholders object that the Bank of America senior secured claim was artificially impaired because the plan needlessly deferred payment of approximately \$1 million in default interest in installments over the course of a year. Because it was *251 receiving the balance of its claim in cash at confirmation, Bank of America voted to confirm the plan. Despite the apparent arbitrariness of this impairment from a business standpoint, the bankruptcy court approved the classification.

[36] [37] The bifurcation of unsecured "trade" [38] claims and the Noteholders' deficiency claim is even more troubling. Class 8 includes, inter alia, trade claims of vendors not previously deemed "critical" and claims by former Scopac employees. Class 9 is the Noteholders' deficiency claim. Legally, these unsecured claims are on equal footing. The bankruptcy court's findings that Class 8 claims are necessary to sustain the reorganization are odd. Under the Bankruptcy Code, classes must contain "substantially similar" claims, but similar claims can be separated into different classes for "good business reasons." In re Greystone III Joint Venture, 995 F.2d 1274, 1281 (5th Cir.1991). Permissible justifications vary with circumstances, but "[i]n many bankruptcies, the proffered reasons ... will be insufficient to warrant separate classification." Matter of Briscoe, 994 F.2d at 1167. Facilitating a plan's confirmation is definitely not a valid justification. As this court has held, "thou shalt not classify similar claims differently in order to gerrymander an affirmative vote on reorganization." Greystone, 995 F.2d at 1279.

[39] Nonetheless, we must hold these impairment and classification contentions equitably moot. Because the plan has been substantially consummated, the smaller unsecured creditors—irrespective of their status vis à vis the reorganized

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

companies—have received payment for their claims. Thirdparty expectations cannot reasonably be undone, and no remedy for the Noteholders' contentions is practicable other than unwinding the plan. These contentions are not remediable on appeal.

5. Unfair Discrimination against Noteholders' Unsecured Deficiency Claim

[40] A cramdown plan must not discriminate unfairly between claims of equal legal priority. 11 U.S.C. § 1129(b)(1). The MRC/Marathon Plan treats unsecured claims in Classes 8 and 9 radically differently. The Class 8 creditors have received approximately 75–90% of their unsecured claims, while the Noteholders' Class 9 deficiency claim, relegated to speculative returns from pending litigation, will probably receive nothing. The bankruptcy court purported to justify the difference based on the supposed essential nature of Class 8 creditors' services to the reorganized company.

[41] As with the preceding complaints about claim impairment and classification, we are bound, if equitable mootness means anything, for the reasons just stated to decline appellate review of this issue.

6. Legality of Non–Debtor Exculpation and Release Clause The plan releases MRC, Marathon, Newco, Townco, and the Unsecured Creditors' Committee (and their personnel) from liability—other than for willfulness and gross negligence—related to proposing, implementing, and administering the plan. The law states, however, that "discharge of a debt of the debtor does not affect the liability of any other entity on ... such debt." 11 U.S.C. § 524(e).

[42] Preliminarily, this claim is not equitably moot. "[E]quity 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). MRC/Marathon *252 insist the release clause is part of their bargain because without the clause neither company would have been willing to provide the plan's financing. Nothing in the record suggests that MRC/Marathon, the Committee, or the Debtors' officers and directors were co-liable for the Debtors' pre-petition debts. Instead, the bargain the proponents claim to have purchased is exculpation from any negligence that occurred during the course of the bankruptcy. Any costs the released parties might incur defending against suits alleging such negligence are unlikely to swamp either these parties or the consummated reorganization. ²⁶ In short,

the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the process. We see little equitable about protecting the released non-debtors from negligence suits arising out of the reorganization. In a variety of contexts, this court has held that Section 524(e) only releases the debtor, not co-liable third parties. See, e.g., In re Coho Resources, Inc., 345 F.3d 338, 342 (5th Cir.2003); Hall v. National Gypsum Co., 105 F.3d 225, 229 (5th Cir.1997); Matter of Edgeworth, 993 F.2d 51, 53–54 (5th Cir.1993); Feld v. Zale Corporation, 62 F.3d 746 (5th Cir.1995). These cases seem broadly to foreclose nonconsensual non-debtor releases and permanent injunctions. ²⁷

MRC/Marathon suggest we adopt a more lenient approach to non-debtor releases taken by other courts. *See SEC v. Drexel Burnham Lambert Group*, 960 F.2d 285, 293 (2d Cir.1992); *In re A.H. Robins*, 880 F.2d 694, 701 (4th Cir.1989). Besides conflicting with *Feld v. Zale Corp.*, these cases all concerned global settlements of mass claims against the debtors and co-liable parties. *See In re Continental Airlines*, 203 F.3d 203, 212–13 (3d Cir.2000) (surveying circuit law on non-debtor releases). In fact, the Bankruptcy Code now permits bankruptcy courts to enjoin third-party asbestos claims under certain circumstances, 11 U.S.C. § 524(g), which suggests non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets. *MacArthur Co. v. Johns–Manville Corp.*, 837 F.2d 89, 90 (2d Cir.1988) (describing channeling function).

[44] There are no allegations in this record that either MRC/Marathon or their or the Debtors' officers or directors were jointly liable for any of Palco's or Scopac's pre-petition debt. They are not guarantors or sureties, nor are they insurers. Instead, the essential function of the exculpation clause proposed here is to absolve the released parties from any negligent conduct that occurred during the course of the bankruptcy. The fresh start § 524(e) *253 provides to debtors is not intended to serve this purpose.

We agree, however, with courts that have held that 11 U.S.C. § 1103(c), which lists the creditors' committee's powers, implies committee members have qualified immunity for actions within the scope of their duties. See In re PWS Holding Corp., 228 F.3d 224, 246 (3d Cir.2000) (citing In re L.F. Rothschild Holdings, Inc., 163 B.R. 45, 49 (S.D.N.Y.1994); In re Drexel Burnham Lambert Group, Inc., 138 B.R. 717, 722 (Bankr.S.D.N.Y.1992)). See also 7 Lawrence P. King et al., Collier on Bankruptcy ¶ 1103.05[4][b] (15th ed. rev.2008) ("[A]ctions against committee members in their capacity as

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

such should be discouraged. If members of the committee can be sued by persons unhappy with the committee's performance during the case or unhappy with the outcome of the case, it will be extremely difficult to find members to serve on an official committee."). The Creditors' Committee and its members are the only disinterested volunteers among the parties sought to be released here. The scope of protection, which does not insulate them from willfulness and gross negligence, is adequate.

Consequently, the non-debtor releases must be struck except with respect to the Creditors Committee and its members.

CONCLUSION

For the foregoing reasons, we affirm in part, reverse in part, and remand for further proceedings consistent herewith.

All Citations

584 F.3d 229, 52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

Footnotes

- Debtor Scotia Pacific initially joined in this appeal, but it was dissolved as part of the plan of reorganization and moved to be dismissed.
- The other four debtors were Britt Lumber Company, Inc., a manufacturer of fencing and decking products; Scotia Inn, Inc., operator of the inn in Scotia, California; Salmon Creek, LLC, a holding company owning roughly 1,300 acres of timberland; and Scotia Development Corp., LLC, a development corporation for exploring and facilitating development opportunities with respect to commercial, industrial, and residential properties in California and Texas. These four entities and Scopac are all wholly owned by Palco.
- The court characterized the Indenture Trustee's plan as a liquidation plan, not a reorganization plan. The plan provided for a six-month period to market and sell Scopac's assets. As evidence of the plan's feasibility, the Indenture Trustee solicited a "stalking horse" bid for \$603 million, but the bankruptcy court found that the bid's term sheet contained numerous contingencies. Further, even the Indenture Trustee did not accept the term sheet, which, the court found, suggested the bid's unreliability. The court also found no evidence that the bidder, were it to win, was capable of operating the Timberlands or complying with a multitude of environmental regulations.
- 4 See 11 U.S.C. § 1126(f), (g). These sections establish, respectively, that unimpaired classes are presumed to have accepted a plan, and classes that will receive nothing are presumed to have rejected a plan.
- 5 See 11 U.S.C. § 1124 (defining impairment).
- In 1996, Palco and its ultimate parent company agreed to sell approximately 5,600 acres of old growth redwood forest to the State of California and to the United States in exchange for approximately \$300 million and 7,755 acres of adjacent timberland. California and the United States also agreed to expedite the regulatory approval process required before Palco could log certain of these lands. This agreement is called the "Headwaters Agreement." Palco and Scopac sued California and two state environmental agencies alleging breach of this agreement.
- Although there is no explicit code provision allowing this practice, bankruptcy courts have used various code provisions to justify otherwise illegal preferential payment of pre-petition unsecured claims to certain vendors necessary for the reorganization. See In re Kmart Corp., 359 F.3d 866 (7th Cir.2004) (discussing the rationale and statutory bases for this practice); see also In re CoServ, LLC, 273 B.R. 487, 492–95 (Bankr.N.D.Tex.2002) (finding authority to pay critical vendors).
- The Indenture Trustee declined to elect under 11 U.S.C. § 1111(b)(2) to have the entire amount of its claim treated as a secured claim. Its claim was therefore severed into a secured claim for the value of the collateral and an unsecured claim for the difference. 11 U.S.C. § 506(a).

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

- 9 The court also credited witness testimony that the Noteholders will receive more under the MRC/Marathon plan than under the Indenture Trustee's plan or in Chapter 7, satisfying 11 § U.S.C. 1129(a)(7).
- The plan established a litigation trust to pursue various causes of action on behalf of the Debtors. The court held that the proposed trust effected a substantive consolidation because it commingled potential recoveries for Palco and Scopac debtors. The court advised that the trust should either be divided into one for Palco and one for Scopac or should separately account for recovery within one trust.
- 11 Courts have implied in 11 U.S.C. § 507(b) a right to a superpriority administrative claim for the diminution of value of collateral during the operation of the automatic stay (11 U.S.C. § 362). *E.g., In re Blackwood Associates, L.P.,* 153 F.3d 61, 68 (2d Cir.1998); *In re Carpet Ctr. Leasing Co.,* 4 F.3d 940, 940 (11th Cir.1993).
- 12 See 11 U.S.C. §§ 503(b)(3)(D), 507(a)(2) (establishing that the legal fees of an indenture trustee making a substantial contribution to a chapter 11 case are priority unsecured claims).
- 13 This court has jurisdiction over this appeal directly from bankruptcy court pursuant to 28 U.S.C. § 158(d)(2) based on the certification by the bankruptcy court and this court's acquiescence therein.
- 14 Compare In re Continental Airlines, 91 F.3d 553, 568–72 (en banc) (Alito, J., dissenting) (discussing the origin of equitable mootness doctrine and concluding that, because it is neither jurisdictional nor a question of justiciability, courts need not consider equitable mootness before the merits).
- 15 11 U.S.C. §§ 363(m), 364(e). These provisions prevent the appellate reversal of an order to sell property or obtain post-petition financing unless such orders were stayed pending appeal.
- 16 11 U.S.C. § 1127.
- Two of our decisions declining to review bankruptcy appeals on equitable mootness grounds are not to the contrary. In *In re Crystal Oil*, this court declined to impose additional, more onerous payment terms for notes issued pursuant to a substantially consummated plan. The court observed that awarding such relief on appeal would harm the first lienholder who had made significant concessions, to the benefit of the junior lienholder who was the appellant. 854 F.2d 79, 81–82 (5th Cir.1988). Similarly, in *In re Brass Corporation*, this court declined to perform the "proposed day surgery" on a consummated Chapter 11 plan because such relief "would excise parts to which other vital[] [parts] of the plan are attached." 169 F.3d 957, 962 (5th Cir.1999). These decisions were rooted in determinations that any relief would either harm third-parties or threaten the reorganization.
- See, e.g., Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 589–90, 55 S.Ct. 854, 863, 79 L.Ed. 1593 (1935) (takings clause); Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440, 470, 57 S.Ct. 556, 565, 81 L.Ed. 736 (1937) (due process clause); Dewsnup v. Timm, 502 U.S. 410, 418–19, 112 S.Ct. 773, 779, 116 L.Ed.2d 903 (1992) (citing Radford with approval).
- Equitable mootness should protect legitimate expectations of parties to bankruptcy cases but should not be a shield for sharp or unauthorized practices. Applying equitable mootness too broadly to disfavor appeals challenging the treatment of secured debt carries a price. It may promote the confirmation of reorganization plans, but it also destabilizes the credit market for financially troubled companies. Lenders will be reluctant to work with debtors who may unilaterally decide to file bankruptcy, propose a plan that aggressively undervalues the collateral, and may then thwart appellate review by rotely incanting equitable mootness. On the whole, it is preferable to create an environment in which firms can avoid bankruptcy rather than one in which bankruptcy litigiousness will thrive.
- The absolute priority rule provides that "a plan of reorganization may not allocate any property whatsoever to any junior class on account of their interests or claims in a debtor unless such senior classes receive property equal in value to the full amount of their allowed claims" 7 Lawrence P. King et al., Collier on Bankruptcy ¶ 1129.04 [4] [a], at 1192–93 (15th ed. rev.2008).

In re Pacific Lumber Co., 584 F.3d 229 (2009)

52 Bankr.Ct.Dec. 46, Bankr. L. Rep. P 81,642

- Section 506(a) bifurcates secured debt into an allowed secured claim equaling the value of the underlying collateral and a general unsecured claim for any deficiency. A creditor may elect in certain circumstances to treat an entire debt as secured in connection with a plan of reorganization. See 11 U.S.C. § 1111(b). The Noteholders made no such election here.
- The Noteholders parry this point with the assertion that if the plan had rested on a Clause (i) payment stream, they could have insisted, with a § 1111(b)(2) election, that the total payments equal their total debt of over \$700 million. This is true, but the present value of the payment stream is still capped by Clause (i) at the collateral value assessed by the court.
- One expert valued only six parcels of land called the Marbled Murrelet Conservation Areas (MMCAs). These approximately 6,600 acres were part of the Headwaters Agreement, and timber harvesting is essentially forbidden on them for the next 40 years.
- The Indenture Trustee also asserts that the bankruptcy court necessarily failed to provide the Noteholders with the indubitable equivalent value of property secured by their lien because it did not value the non-timberland collateral. This is incorrect. The bankruptcy court expressly valued the Noteholders non-timberland collateral at \$48.7 million, an amount representing cash and cash equivalents in Scopac's accounts on the petition date. After subtracting the Bank of America's priming lien and the Indenture Trustee's legal fees, the net value of the non-timberland collateral was \$3.6 million. The court added this amount to its prior timberland valuation of \$510 million, and the sum represented the total value of collateral secured by the Noteholders' lien.

Against these findings, the Indenture Trustee asserts in its principal brief that its security interests in "personal property covered by the Uniform Commercial Code" and "any goods or any other personal property that may not or hereafter become fixtures," were left out of valuation. In its reply brief, it describes the omitted property as "plant and equipment, and non-timberland real property." These vague and contradictory assertions are insufficient to raise an intelligible appellate point.

- Substantive consolidation is of special concern in cases involving special purpose entities like Scopac. Special purpose entities are often used in securitized lending because they are bankruptcy-remote, that is, they decrease the likelihood that the originator's financial trouble will affect the special purpose entity's assets serving as collateral for the notes. Nevertheless, there is a danger that a court will substantively consolidate the two entities, using the value of the investors' collateral to satisfy the originator's debts. If courts are not wary about substantive consolidation of special purpose entities, investors will grow less confident in the value of the collateral securing their loans; the practice of securitization, a powerful engine for generating capital, will become less useful; and the cost of capital will increase.
- Because the Noteholders do not brief why Newco and Townco (or their officers and directors) should not be released, we do not analyze their position.
- Two cases cast doubt on this categorical prohibition against non-debtor releases, but these cases are distinguishable because they concern the *res judicata* effect of non-debtor releases, not their legality. In *Republic Supply Company v. Shoaf*, 815 F.2d 1046 (5th Cir.1987), this court ruled that *res judicata* barred a debtor from bringing a claim that was specifically and expressly released by a confirmed reorganization plan because the debtor failed to object to the release at confirmation. The current case is distinguishable because it presents an appeal of a confirmation order, not a separate action, barred by the exculpation provision, collaterally attacking the legality of the release. This court's opinion in *Applewood Chair Co. v. Three Rivers Planning & Development District*, 203 F.3d 914, distinguishes *Shoaf* by holding that the release at issue there was not specific. *Applewood* did not find specific releases satisfy § 524(e), instead it held that this court would only give res judicata effect to specific clauses.

End of Document

© 2022 Thomson Reuters. No claim to original U.S.
Government Works.

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

KeyCite Yellow Flag - Negative Treatment
Certificate of Appealability Granted by In re Purdue Pharma, L.P., S.D.N.Y.,
January 7, 2022

635 B.R. 26

United States District Court, S.D. New York.

IN RE: PURDUE PHARMA, L.P.

This Filing Relates to All Matters

21 cv 7532 (CM) [Master Case]

[rel: 21 cv 7585 (CM)

21 cv 7961 (CM), 21 cv 7962 (CM), 21 cv 7966 (CM), 21 cv 7969 (CM), 21 cv 8034 (CM), 21 cv 8042 (CM), 21 cv 8049 (CM), 21 cv 8055 (CM), 21 cv 8139 (CM), 21 cv 8258 (CM), 21 cv 8271 (CM), 21 cv 8548 (CM), 21 cv 8557 (CM), 21 cv 8566 (CM)]

Signed 12/16/2021

Synopsis

Background: Chapter 11 debtors, a privately-held pharmaceutical company and affiliated entities involved in the manufacture and promotion of a proprietary prescription opioid pain reliever, sought confirmation of proposed plan of reorganization which, inter alia, contained broad releases of civil claims against non-debtor family members who owned debtors and against their related entities. United States Trustee (UST), numerous states and municipalities, and others objected. The Bankruptcy Court, Robert D. Drain, J., 633 B.R. 53, entered order confirming plan. Appeal was taken from that order as well as two merged and related orders, one approving debtors' disclosure statement and solicitation materials, and the other authorizing the implementation of certain preliminary aspects of plan.

Holdings: The District Court, Colleen McMahon, J., held that:

[1] the Bankruptcy Court lacked constitutional authority to enter a final order approving the non-consensual releases, even though they were incorporated into proposed plan, and so standard of review was de novo as to both the Bankruptcy Court's factual findings and its conclusions of law;

- [2] the Bankruptcy Court had subject matter jurisdiction to approve the release of claims against non-debtors;
- [3] addressing an issue of apparent first impression for the court, the Bankruptcy Code does not authorize a bankruptcy court to order the non-consensual release of non-derivative third-party claims against non-debtors in connection with confirmation of a Chapter 11 plan; and
- [4] the plan's classification and treatment of the claims of Canadian unsecured creditors vis-a-vis those of their domestic unsecured creditor "counterparts" did not violate the Code

Vacated.

West Headnotes (70)

[1] Bankruptcy - Number of creditors and amount of claims concurring

Under the Bankruptcy Code, a Chapter 11 plan must be approved, not by a supermajority of all eligible voters, but by a supermajority of all actual voters. 11 U.S.C.A. § 1126.

[2] Bankruptcy & Appointment; Election

Bankruptcy & Representation of debtor, estate, or creditors

United States Trustee (UST) is a Department of Justice (DOJ) official appointed by the Attorney General to supervise the administration of bankruptcy cases and, under the Bankruptcy Code, has standing to appear in bankruptcy cases and comment on proposed disclosure statements and Chapter 11 plans. 11 U.S.C.A. § 307; 28 U.S.C.A. §§ 581-589.

[3] Bankruptcy - Construction and Operation

Bankruptcy Code is "comprehensive scheme" devised by Congress for resolving debtor-creditor relations.

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

[4] Bankruptcy — Judicial authority or approval Bankruptcy courts consider the factors set forth

by the Second Circuit in *Iridium*, 478 F.3d 452, in evaluating the fairness of proposed settlements.

[5] Bankruptcy Property held in trust or custody for debtor; deposits

Spendthrift trusts can and often do insulate assets from the bankruptcy process.

[6] Bankruptcy Conclusions of law; de novo review

Bankruptcy 🧽 Clear error

Generally, in bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law de novo. Fed. R. Bankr. P. 8013.

[7] Bankruptcy 💝 Conclusions of law; de novo

Bankruptcy court's conclusions of law, reviewed de novo, include rulings as to the bankruptcy court's jurisdiction and interpretations of the Constitution. Fed. R. Bankr. P. 8013.

[8] Bankruptcy 🤛 Clear error

Clear error standard used by the district court in reviewing a bankruptcy court's findings of fact is a deferential one. Fed. R. Bankr. P. 8013.

[9] Bankruptcy 🧽 Clear error

Bankruptcy court's finding of fact is "clearly erroneous" only if the district court is left with the definite and firm conviction that a mistake has been committed. Fed. R. Bankr. P. 8013.

[10] Bankruptcy Submission to district court for judgment

Standard of review applied by the district court in reviewing a bankruptcy court's findings of fact is far less deferential if bankruptcy court is presented with something it cannot adjudicate to final judgment as constitutional matter unless parties consent; in such circumstance, bankruptcy judge has authority only to hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for de novo review and entry of judgment. Fed. R. Bankr. P. 8013.

[11] Bankruptcy - District court review or decision

If bankruptcy court issues final order in mistaken belief that it has constitutional authority to do so, district court can treat bankruptcy court's order as report and recommendation, but it must review proceeding de novo and enter final judgment.

[12] Bankruptcy - Particular proceedings or

Bankruptcy Issues between non-debtors

On Chapter 11 debtors' motion to confirm proposed plan of reorganization, the Bankruptcy Court lacked constitutional authority under Stern to enter a final order approving the nonconsensual third-party releases incorporated into the plan, and so, on appeal of the Bankruptcy Court's confirmation order, the standard of review was de novo as to both the Bankruptcy Court's factual findings and its conclusions of law; even though the Bankruptcy Court had authority to confirm the plan, which was a core function of a bankruptcy court, the nonconsensual releases applied to third-party claims against non-debtors, such third-party claims neither stemmed from debtors' bankruptcy nor would necessarily be resolved in the claims allowance process, and the Bankruptcy Court had only "related to" jurisdiction over them. 28 U.S.C.A. § 157(a); Fed. R. Bankr. P. 8013.

4 Cases that cite this headnote

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

[13] Bankruptcy Core, Non-Core, or Related Proceedings in General; Nexus

Under statute governing bankruptcy procedure, Congress divided bankruptcy proceedings into three types: (1) those that "arise under" title 11, (2) those that "arise in" a title 11 case, (3) and those that are "related to" a title 11 case. 28 U.S.C.A. § 157(a).

[14] Bankruptcy Core or non-core proceedings

Cases that "arise under" or "arise in" a title 11 matter are known as "core" bankruptcy proceedings, while "related to" proceedings are "non-core." 28 U.S.C.A. §§ 157(a), 157(b)(1)-(2)(C).

[15] Bankruptcy Core or non-core proceedings

Every proceeding pending before a bankruptcy court is either core or non-core. 28 U.S.C.A. § 157(a).

[16] Bankruptcy Core or non-core proceedings

Core versus non-core distinction is critical when assessing bankruptcy court's constitutional authority to enter final judgment disposing of particular proceeding. 28 U.S.C.A. § 157(a).

[17] Bankruptcy • Core or non-core proceedings

Core/non-core distinction is critically important when assessing the bankruptcy court's subject matter jurisdiction. 28 U.S.C.A. § 157(a).

[18] Bankruptcy 🧽 Related proceedings

Bankruptcy court lacks constitutional authority to enter final judgment in proceeding over which it has only "related to" subject matter jurisdiction unless all parties consent. 28 U.S.C.A. § 157(a).

[19] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

A party otherwise entitled to have a matter adjudicated by an Article III court does not forfeit that constitutional right if the matter is disposed of as part of a plan of reorganization in bankruptcy. U.S. Const. art. 3.

1 Cases that cite this headnote

[20] Bankruptcy 🧽 Bankruptcy Jurisdiction

Pursuant to *Stern*, bankruptcy courts have the power to enter a final judgment only in proceedings that stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process.

[21] Bankruptcy Settlement, adjustment, or enforcement of claims

Debtors and their affiliated non-debtor parties cannot manufacture constitutional authority for bankruptcy court to resolve non-core claim by artifice of including release of that claim in plan of reorganization.

2 Cases that cite this headnote

[22] Bankruptcy Settlement, adjustment, or enforcement of claims

In assessing a bankruptcy court's jurisdiction to enjoin a third-party dispute under a plan, the question is not whether the court has jurisdiction over the settlement that incorporates the thirdparty release, but whether it has jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party.

[23] Bankruptcy Consent to or Waiver of Objections to Jurisdiction or Venue

Bankruptcy Settlement, adjustment, or enforcement of claims

A bankruptcy court's order extinguishing a noncore claim and enjoining its prosecution without an adjudication on the merits finally determines

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

that claim and is equivalent to entering a judgment dismissing the claim and bars the claim under principles of former adjudication; therefore, Congress may not allow a bankruptcy court to enter such an order absent the parties' consent.

[24] Bankruptcy 🧽 Bankruptcy Jurisdiction

Bankruptcy court is creature of statute.

[25] Bankruptcy 🤛 Jurisdiction over property

Bankruptcy court's subject matter jurisdiction is in rem and is limited to res of estate.

[26] Bankruptcy Core, Non-Core, or Related Proceedings in General; Nexus

A proceeding "arises under" title 11, for jurisdictional purposes, if the claims invoke substantive rights created by that title. 28 U.S.C.A. § 1334(b).

[27] Bankruptcy Core, Non-Core, or Related Proceedings in General; Nexus

A proceeding "arises in" a title 11 case, for jurisdictional purposes, if, for example, parties, by their conduct, submit themselves to the bankruptcy court's jurisdiction by litigating proofs of claim without contesting personal jurisdiction. 28 U.S.C.A. § 1334(b).

[28] Bankruptcy 🤛 Related proceedings

A proceeding is "related to" a title 11 proceeding, for jurisdictional purposes, if its outcome might have any conceivable effect on the bankrupt estate. 28 U.S.C.A. § 1334(b).

[29] Bankruptcy 🤛 Issues between non-debtors

Release of most third-party claims against non-debtor touches outer limit of bankruptcy court's jurisdiction. 28 U.S.C.A. § 1334(b).

[30] Bankruptcy 🧽 Related proceedings

Standard for bankruptcy court's jurisdiction is not that action's outcome will certainly have, or even that it is likely to have, an effect on res of estate; rather, it is whether it might have any conceivable impact on estate. 28 U.S.C.A. § 1334(b).

[31] Bankruptcy 🧽 Related proceedings

The only question a bankruptcy court need ask in determining whether it can exercise "related to" jurisdiction is whether the action's outcome might have any conceivable effect on the bankrupt estate; if the answer to that question is yes, then related to jurisdiction exists, no matter how implausible it is that the action's outcome actually will have an effect on the estate. 28 U.S.C.A. § 1334(b).

[32] Bankruptcy - Particular proceedings or issues

Under governing broad standard, the Bankruptcy Court had "related to" subject matter jurisdiction to approve, as part of proposed plan of reorganization, a release of non-derivative third-party claims against non-debtor family members who owned Chapter 11 debtors; civil proceedings asserted against non-debtor family members might have had conceivable impact on the rest of the estate, as pursuit of such claims threatened to unravel plan's intricate settlements, to alter liabilities of the estate, and to change amount available for distribution to other creditors, all claims in case had high degree of interconnectedness with lawsuits against debtors and against family members, and it was likely that debtors' litigation of their indemnification, contribution, and/or insurance obligations to family members who had served as their directors, officers, or managers would burden estate assets. 28 U.S.C.A. § 1334(b).

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

[33] Insurance - Public policy limitations in general

Insurance ← Defense Costs, Supplementary Payments and Related Expenses

Insurance 🤛 Scope of Duty

California law specifically prohibits indemnity or insurance coverage for losses resulting from a violation of its false advertising law or unfair competition law, and under that law an insurer has no duty to defend or advance costs. Cal. Ins. Code § 533.5.

[34] Bankruptcy Equitable powers and principles

Bankruptcy Settlement, adjustment, or enforcement of claims

Bankruptcy Code does not authorize a bankruptcy court to order the non-consensual release of non-derivative third-party claims against non-debtors in connection with confirmation of a Chapter 11 plan; sole section of Code expressly authorizing court to enjoin third-party claims against non-debtors without consent of third parties is limited to asbestos cases, neither section of Code authorizing court to enter any "necessary or appropriate" order to carry out provisions of Code nor subsections authorizing a plan to provide adequate means for its implementation or providing that a plan may include "any other appropriate provision" not inconsistent with applicable provisions of Code, whether read individually or together, provide court with such authority, there is no such thing as "equitable authority" or "residual authority" in a bankruptcy court untethered to some specific, substantive grant of authority in Code, and any congressional silence on matter could not be deemed consent. 11 U.S.C.A. §§ 105(a), 524(e), 524(g), 1123(a)(5), 1123(b)(6).

2 Cases that cite this headnote

[35] Bankruptcy & Rights of Action; Contract Rights Generally

Bankruptcy Claims allowable; what constitutes "claim."

"Derivative" claims are those that seek to recover from the bankruptcy estate indirectly on the basis of the debtor's conduct, as opposed to a nondebtor's own conduct.

[36] Bankruptcy & Rights of Action; Contract Rights Generally

Derivative claims in every sense relate to adjustment of debtor-creditor relationship, because they are claims that relate to injury to corporation itself; if creditor's claim is one that bankruptcy trustee could bring on behalf of estate, then it is "derivative."

[37] Bankruptcy — Claims allowable; what constitutes "claim."

In the bankruptcy context, "direct" claims are based upon a "particularized" injury to a third party that can be directly traced to a non-debtor's conduct.

[38] Bankruptcy A Rights of Action; Contract Rights Generally

Claims asserted by states against non-debtor family members who had served as Chapter 11 debtors' officers, directors, or managers, based on family members' alleged violation of state laws under which individuals who serve in certain capacities in a corporation are individually and personally liable for their personal participation in certain unfair trade practices, were not derivative; claims arose out of out of a separate and independent duty that was imposed by statute on individuals who, by virtue of their positions, were alleged to have personally participated in acts of corporate fraud, misrepresentation, and/or willful misconduct.

[39] Statutes 🕪 Language

When assessing statutory authority, courts should turn first to the text of the statute.

[40] Bankruptcy - Injunction or stay of other proceedings

Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third-party claims against non-debtors without the consent of those third parties solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos, and such injunctions cannot be entered in favor of just any non-debtor, but are limited to enjoin actions against a specific set of non-debtors, namely, those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers. 11 U.S.C.A. §§ 524(g), 524(g)(4)(A).

[41] Bankruptcy 🕪 Exemptions

Bankruptcy Code explicitly exempts certain debtor assets from the bankruptcy estate and provides a finite number of exceptions and limitations to those asset exemptions; courts are not authorized to create additional exceptions. 11 U.S.C.A. § 522.

[42] Bankruptcy - Preservation of priority

In Chapter 11 bankruptcies, a plan that does not follow normal priority rules cannot be confirmed over the objection of an impaired class of creditors. 11 U.S.C.A. § 1129(b).

[43] Bankruptcy Effect; proceedings in converted case

In a "structured dismissal," the debtor obtains an order that simultaneously dismisses its Chapter 11 case and provides for the administration and distribution of its remaining assets.

Equitable power conferred on the bankruptcy court by the section of the Bankruptcy Code

authorizing a court to enter any "necessary or appropriate" order to carry out the provisions of title 11 is the power to exercise equity in carrying out the provisions of the Code, rather than to further the purposes of the Code generally, or otherwise to do the right thing. 11 U.S.C.A. § 105(a).

[45] Bankruptcy 🧽 Contents in general

Subsection of Bankruptcy Code providing that Chapter 11 plan may include "any other appropriate provision" not inconsistent with applicable provisions of Code does not confer substantive authority on the bankruptcy court. 11 U.S.C.A. § 1123(b)(6).

[46] Bankruptcy 🤛 Fraud

Congress intended that the Bankruptcy Code ensure that all debts arising out of fraud are excepted from discharge no matter what their form. 11 U.S.C.A. § 523(a)(2), (4), (6).

[47] **Bankruptcy** Fines, penalties, and forfeitures; punitive damages, and interest

Civil penalties payable to and for the benefit of governmental units are not dischargeable in bankruptcy. 11 U.S.C.A. § 523(a)(7).

[48] Bankruptcy Effect as to co-debtors, guarantors, and sureties

Under the Bankruptcy Code, releasing a debtor on a debt owed to a creditor does not affect the liability that a non-debtor may have for the same debt. 11 U.S.C.A. § 524(e).

[49] Bankruptcy 🧽 Means of implementation

Section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation contains a laundry list of things that a Chapter 11 plan can include in order to make sure that resources are available to

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

implement the plan, any of which can be ordered by a bankruptcy court. 11 U.S.C.A. § 1123(a)(5).

[50] Bankruptcy 🧼 Means of implementation

Under the section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation, it is the debtor's resources, not the resources of some third party, that are supposed to be used to implement a plan that will adjust the debtor's relations with its creditors. 11 U.S.C.A. § 1123(a) (5).

[51] Bankruptcy - Means of implementation

Section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation does not confer any special power on the bankruptcy court. 11 U.S.C.A. § 1123(a)(5).

[52] Bankruptcy & Means of implementation

Section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation does not authorize a court to give its imprimatur to something the Code does not otherwise authorize, simply because doing so would ensure funding for a plan. 11 U.S.C.A. § 1123(a)(5).

[53] Bankruptcy 🧽 Means of implementation

Under the section of the Bankruptcy Code providing that a plan of reorganization must provide adequate means for its implementation, the mere fact that money is being used to fund implementation of the plan does not give a bankruptcy court statutory authority to enter an otherwise impermissible order in order to obtain that funding. 11 U.S.C.A. § 1123(a)(5).

[54] Bankruptcy Carrying out provisions of Code

Section of the Bankruptcy Code providing that a bankruptcy court shall confirm a Chapter 11 plan only if the plan complies with applicable provisions of title 11 confers no substantive right that could be used to undergird an injunction under the section of the Code authorizing the court to enter any "necessary or appropriate" order to carry out the provisions of title 11. 11 U.S.C.A. §§ 105(a), 1129(a)(1).

[55] Bankruptcy - Construction and Operation

Bankruptcy Code provides comprehensive federal system to govern orderly conduct of debtors' affairs and creditors' rights.

[56] Bankruptcy 🕪 Purpose

Bankruptcy Code was intended to free the debtor of personal obligations while ensuring that no one else reaps a similar benefit.

[57] Statutes — General and specific terms and provisions; ejusdem generis

Statutes General and specific statutes

It is a commonplace of statutory construction that the specific governs the general.

[58] Bankruptcy 🧽 Construction and Operation

The "general/specific canon" of statutory interpretation applies with particular force in bankruptcy, where Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.

[59] Bankruptcy 🤛 Power and Authority

Any "residual authority" of a bankruptcy court, if it even exists, cannot be exercised in contravention of specific provisions of the Bankruptcy Code.

[60] Bankruptcy 🧽 Issues between non-debtors

"Special remedial scheme" contemplated by the Bankruptcy Code addresses the rights of persons who have claims against a debtor in bankruptcy, not claims against other non-debtors.

[61] Bankruptcy 🕪 Determination

Bankruptcy Code lays out a claims allowance process so that creditors can file their claims against someone who has invoked the protection of the Code; it provides a mechanism for those parties to litigate those claims against the debtor and to determine their value.

[62] Bankruptcy ← Effect of Bankruptcy Relief; Injunction and Stay

In order to take advantage of the "special remedial scheme" set forth in the Bankruptcy Code, debtors have to declare bankruptcy, disclose their assets, and apply them, that is, all of them, with de minimis exceptions, to the resolution of the claims of their creditors.

Bankruptcy • Issues between non-debtors

Just as a bankruptcy court's ability to provide finality to a third party is defined by its jurisdiction, not its good intentions, so too its power to grant relief to a non-debtor from non-derivative third-party claims can only be exercised within confines of Bankruptcy Code.

[64] Bankruptcy 🧽 Classification of claims

Classification and treatment of the claims of Canadian claimants vis-a-vis those of their domestic unsecured creditor "counterparts" by Chapter 11 plan of debtors, a privately-held pharmaceutical company and affiliated entities, did not violate the Bankruptcy Code; under the plan, Canadian claimants belonged to a different class, general unsecured creditors, than their domestic unsecured creditor "counterparts,"

which were placed in classes as "non-federal domestic governmental" claimants and "tribe" claimants, respectively, for legitimate reasons, given, inter alia, that Canadian claimants operated under different regulatory regimes with regard to opioids and abatement than their domestic counterparts and that the bulk of their legal claims arose in Canada, and there was no argument that the separate classification was done to disenfranchise a group, to engineer an assenting impaired class, or to manipulate class voting. 11 U.S.C.A. §§ 1129(a)(4), 1129(b)(1).

[65] Bankruptcy 🧽 Classification of claims

Bankruptcy Code does not require that all creditor classes be treated equally, only that there be a reasonable basis for any differentiation. 11 U.S.C.A. §§ 1129, 1129(a)(4).

[66] Bankruptcy 💝 Classification of claims

Bankruptcy Code expressly permits differentiation between classes of creditors.

[67] Bankruptcy & Equality of treatment within classes

Bankruptcy Code's "equal-treatment mandate" with respect to a Chapter 11 plan's treatment of creditors applies only to claims of all creditors within the same class. 11 U.S.C.A. § 1129(a)(4).

[68] Bankruptcy 🧽 Classification of claims

It does not matter that certain creditors' claims are purportedly "indistinguishable" from those held by other creditors; a Chapter 11 plan may separately classify similar claims so long as the classification scheme has a reasonable basis for doing so. 11 U.S.C.A. § 1129.

[69] Bankruptcy 🐆 Classification of claims

In evaluating a Chapter 11 plan's separate classification of creditors, the court must carefully scrutinize whether such classification

was done for the purpose of disenfranchising a particular group in a manner inconsistent with the Bankruptcy Code, to engineer an assenting impaired class, or manipulate class voting. 11 U.S.C.A. § 1129.

[70] Bankruptcy ← Fairness and Equity; "Cram Down."

Under the Bankruptcy Code, only creditors of a dissenting class can object to the confirmation of a Chapter 11 plan on the grounds that the plan discriminates against their creditor class. 11 U.S.C.A. § 1129(b)(1).

Attorneys and Law Firms

*34 Timothy E. Graulich, Marshall Scott Huebner, Benjamin S. Kaminetzky, Christopher Scott Robertson, Eli James Vonnegut, Davis Polk & Wardwell LLP, New York, NY, for In re: Purdue Pharma, L.P.

DECISION AND ORDER ON APPEAL

McMahon, J.:

This is an appeal from an order of the United States Bankruptcy Court for the Southern District of New York ("Bankruptcy Court") (Drain, B.J.), announced from the bench on September 1, 2021, and filed on September 17, 2021, confirming the Plan of Reorganization proposed by Debtors Purdue Pharma L.P. ("Purdue Pharma") and certain associated companies (the "Confirmation Order"). Appeal is also taken from two merged and related orders of the Bankruptcy Court: the June 3, 2021, order approving Purdue's disclosure statement and solicitation materials (the "Disclosure Order") and the September 15, 2021, order authorizing the implementation of certain preliminary aspects of the Plan (the "Advance Order").

Purdue's bankruptcy was occasioned by a health crisis that was, in significant part, of its own making: an explosion of opioid addiction in the United States over the past two decades, which can be traced largely to the over-prescription

of highly addictive medications, including, specifically and principally, Purdue's proprietary, OxyContin.

Despite a 2007 Plea Agreement with the United States - in which Purdue admitted that it had falsely marketed OxyContin as non-addictive and had submitted false claims to the federal government for reimbursement of medically unnecessary opioid prescriptions ("2007 Plea Agreement") - Purdue's profits after 2007 were driven almost exclusively by its aggressive marketing of OxyContin. (See JX-2094.0047-88; JX-2481). But by 2019, Purdue was facing thousands of lawsuits brought by persons who had become addicted to OxyContin and by the estates of addicts who had overdosed - either on OxyContin itself or on the street drugs (heroin, fentanyl) for which Purdue's product served as a feeder. It also faced new federal, state and local Medicare reimbursement claims and a number of new false marketing claims brought under various state consumer protection *35 laws. Finally, in November 2020, Purdue pled guilty to a criminal Information filed by the Department of Justice ("DOJ") in the United States District Court for the District of New Jersey; in its plea agreement, the company (though not the people through whom the company acted) admitted to substantial deliberate wrongful conduct ("2020 Plea Agreement"). See USA v. Purdue Pharma L.P., No. 2:20cr-01028.

Engulfed in a veritable tsunami of litigation, Purdue filed for chapter 11 bankruptcy in September 2019. The intent was for a "Manville-style" bankruptcy that would resolve both existing and future claims against the company arising from the prescription of OxyContin. The automatic stay brought a stop to civil litigation against Purdue; and a court-ordered stay halted litigation against certain non-debtors affiliated with the company - principally members of the Sackler family (the "Sacklers" or "Sackler family"), which had long owned the privately-held company – to buy time to craft a resolution. For two years, committees of various classes of creditors individuals, state and local governments, indigenous North American tribes, even representatives of unborn children who were destined to suffer from opioid addiction - negotiated with Purdue and the Sacklers under the watchful eye of the experienced Bankruptcy Judge, with the assistance of two of this country's finest and most experienced mediators (Layn Phillips and Kenneth Feinberg), as well as a second Bankruptcy Judge (The Hon. Shelley Chapman).

[1] Eventually, the parties crafted a plan of reorganization for Purdue that would, if implemented, afford billions of

dollars for the resolution of both private and public claims, while funding opioid relief and education programs that could provide tremendous benefit to the consuming public at large (the "Plan"). That Plan was approved by supermajority of the votes cast by the members of each class of creditors. It was confirmed by Judge Drain, who had invested so much of himself in the effort to find a workable solution to a seemingly intractable problem.

[2] But not everyone voted yes. Eight states and the District of Columbia ("D.C."), as well as certain Canadian municipalities and Canadian indigenous tribes, the City of Seattle (alone among all voting municipalities in the United States), as well as some 2,683 individual personal injury claimants, voted against the adoption of the Plan. The same states, municipalities and tribes, together with three of those individual claimants (representing themselves), filed formal objections to the Plan and have appealed from its confirmation. The United States Trustee (the "U.S. Trustee") in Bankruptcy⁶ and the U.S. *36 Attorney's Office for this District on behalf of the United States of America join in their objections.

All Appellants assign the same reason for their opposition: the Plan provides broad releases, not just of derivative, but of particularized or direct claims - including claims predicated on fraud, misrepresentation, and willful misconduct under various state consumer protection statutes – to the members of the Sackler family (none of whom is a debtor in the bankruptcy case) and to their affiliates and related entities. As the opioid crisis continued and worsened in the wake of Purdue's 2007 Plea Agreement, the Sacklers - or at least those members of the family who were actively involved in the day to day management of Purdue⁷ – were well aware that they were exposed to personal liability over OxyContin. Concerned about how their personal financial situation might be affected, the family began what one member described as an "aggressive[]" program of withdrawing money from Purdue almost as soon as the ink was dry on the 2007 papers. The Sacklers upstreaming some \$10.4 billion out of the company between 2008 and 2017, which, according to their own expert, substantially reduced Purdue's "solvency cushion." Over half of that money was either invested in offshore companies owned by the Sacklers or deposited into spendthrift trusts that could not be reached in bankruptcy and off-shore entities located in places like the Bailiwick of Jersey.

When the family fortune was secure, the Sackler family members withdrew from Purdue's Board and management. Bankruptcy discussions commenced the following year. As part of those pre-filing discussions, the Sacklers offered to contribute toward a settlement, but if – and only if – every member of the family could "achieve global peace" from all civil (not criminal) litigation, including litigation by Purdue to claw back the money that had been taken out of the corporation. The Plan confirmed by the Bankruptcy Court extinguishes all civil claims against the Sacklers that relate in any way to the operations of Purdue – including claims on which certain members of the Sackler family could be held personally liable to entities other than Purdue (principally the various states). These claims could not be released if the Sacklers were themselves debtors in bankruptcy.

Appellants attack the legality of the Plan's non-consensual release of third-party claims against non-debtors on a number of grounds. They argue that the release (referred to in this opinion as the "Section 10.7 Shareholder Release") is both constitutionally defective and not statutorily authorized; that the Bankruptcy Court lacks constitutional authority and subject matter jurisdiction to approve the release or to carry out certain "gatekeeping" aspects of the Plan that relate to it; and that granting a release to the non-debtor Sacklers is unwarranted as a matter of fact and would constitute an abuse of the bankruptcy process.

*37 Debtors and those who voted in favor of the Plan – buttressed by Judge Drain's comprehensive Confirmation Order – argue that the Bankruptcy Court had undoubted jurisdiction to impose these broad third-party releases; insist that they are a necessary feature of the Plan; point out the tremendous public benefit that will be realized by implementing the Plan's many forward-looking provisions; and urge that the alternative – Purdue's liquidation – will inevitably yield far less benefit to all creditors and victims, in light of the cost and extraordinary hurdles that would have to be surmounted in order to claw back the billions of dollars that the Sacklers have taken out of Purdue.

Two of the questions raised by appellants are easily answered. The Bankruptcy Court had undoubted subject matter jurisdiction to enter the challenged releases. And while it may have lacked constitutional authority to give them final approval under the rule of *Stern v. Marshall*, 564 U.S. 462 (2011), that matters little in the great scheme of things; it changes the level of deference this court should give to Judge

Drain's findings of fact, but those findings are essentially unchallenged.

The great unsettled question in this case is whether the Bankruptcy Court – or any court – is statutorily authorized to grant such releases. This issue has split the federal Circuits for decades. While the Circuits that say no are united in their reasoning, the Circuits that say yes offer various justifications for their conclusions. And – crucially for this case – although the Second Circuit identified the question as open back in 2005, it has not yet had occasion to analyze the issue. Its only guidance to the lower courts, uttered in that 2005 opinion, is this: because statutory authority is questionable and such releases can be abused, they should be granted sparingly and only in "unique" cases.

This will no longer do. Either statutory authority exists or it does not. There is no principled basis for acting on questionable authority in "rare" or "unique" cases, especially as the United States Supreme Court has recently held that there is no "rare case" rule in bankruptcy that allows a court to trump the Bankruptcy Code. *See Czyzewski v. Jevic Holding Corp.*, — U.S. —, 137 S. Ct. 973, 986, 197 L.Ed.2d 398 (2017).

[3] Moreover, the lower courts desperately need a clear answer. As one of my colleagues on the Bankruptcy Court recently noted, plans releasing non-debtors from third party claims are no rarity: "Unfortunately, in actual practice the parties ... often seek to impose involuntary releases based solely on the contention that anybody who makes a contribution to the case has earned a third-party release. Almost every proposed Chapter 11 Plan that I receive includes proposed releases." In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726 (S.D.N.Y. 2019) (Wiles, B.J.) (emphasis added). When every case is unique, none is unique. Given the frequency with which this issue arises, the time has come for a comprehensive analysis of whether authority for such releases can be found in the Bankruptcy Code – that "comprehensive scheme" devised by Congress for resolving debtor-creditor relations. See RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012).

Aided by superb briefing and argument on both sides of the question, and by extended ruminations on the subject by several esteemed bankruptcy judges of our own District – Judge Drain not the least – this Court concludes that the Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express *38 text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or "residual" powers on a court sitting in bankruptcy. For that reason, the Confirmation Order (and the Advance Order that flows from it) must be vacated.

Because I conclude that the Bankruptcy Court lacked statutory authority to impose the Section 10.7 Shareholder Release, I need not and do not reach the constitutional questions that have been raised by the parties. Nor do I need to decide whether this is a case in which such releases should be imposed if my statutory analysis is incorrect. Those issues may need to be addressed some day, but they do not need to be addressed in order to dispose of this appeal.

This opinion will not be the last word on the subject, nor should it be. This issue has hovered over bankruptcy law for thirty-five years – ever since Congress added §§ 524(g) and (h) to the Bankruptcy Code. It must be put to rest sometime; at least in this Circuit, it should be put to rest now.

PARTIES⁸

The Appellants in this case are the U.S. Trustee William K. Harrington; the States of California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, Washington, and D.C. (together, the "State Appellants"); the City of Grande Prairie as Representative for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin; the Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People; the Peter Ballantyne Cree Nation on behalf itself, and the Lac La Ronge Indian Band (together, the "Canadian Appellants"); and *pro se* Appellants Ronald Bass, Marie Ecke, Andrew Ecke, Richard Ecke, and Ellen Isaacs on Behalf of Patrick Ryan Wroblewski (together, the "Pro Se Appellants").

The Appellees are the Purdue Debtors, as well as the Official Committee of Unsecured Creditors of Purdue Pharma L.P., et al. (the "UCC"), the Ad Hoc Committee of Governmental and Other Contingent Litigation Claimants ("AHC"), the Ad Hoc Group of Individual Victims of Purdue Pharma, L.P. ("PI Ad Hoc Group"), the Multi-State Governmental Entities Group ("MSGE"), the Mortimer-side Initial Covered Sackler

Persons ("Side A"), and the Raymond Sackler Family ("Side B").

The Ad Hoc Committee of NAS Children ("NAS Children") appears as amicus curiae and has filed an amicus brief. (Dkt. No. 158). The U.S. Attorney's Office for this District also appears on behalf of the United States of America as amicus curiae and has filed a statement of interest in this case. (Dkt. No. 94).

BACKGROUND

The following facts are derived from the appellate record as designated by the parties to this appeal, unless indicated otherwise. (See Dkt. Nos. 78-1, 105, 255). The *39 Court judicially notices certain public court records and other matters that are subject to judicial notice. See Fed. R. Evid. 201(b)-(d). 11

I. Purdue Pharma, L.P.

Purdue – originally known as "Purdue Frederick Company" - was founded by John Purdue Gray and George Frederick Bingham in 1892. The company was sold to brothers Arthur, Mortimer and Raymond Sackler in 1952. (See JX-2148; JX-1985, at 33:12-13).

Purdue Pharma, the Debtors' main operating entity, is a Delaware limited partnership headquartered in Stamford, Connecticut. (Dkt. No. 91-4, at App. 1244). Purdue Pharma's general partner is Purdue Pharma Inc. ("PPI"), a New York corporation, also headquartered in Stamford, Connecticut. (Id., JX-1221). The board of directors of PPI manages Purdue Pharma (the "Board"). (Dkt. No. 91-4, at App. 1250). Purdue Pharma has 22 wholly owned subsidiaries in the United States and the British Virgin Islands. (*Id.* at App.1244).

Purdue Pharma is wholly owned by Pharmaceutical Research Associates, L.P. ("PRA"), a Delaware limited partnership that is not a debtor in this case. (Id. at App.1252). PRA is 99.5% owned, in equal parts, by non-debtors Beacon Company ("Beacon"), a Delaware general partnership, and Rosebay Medical Company L.P. ("Rosebay"), a Delaware limited partnership, which are in turn owned by certain trusts established for the benefit of the Sackler Families. (Id.). Beacon is the partnership of Side A of the Sackler family; Rosebay is the partnership of Side B of the Sackler family. (See JX-1987, at 42:10-23; JX-3298 at 160:8-10). 12

Purdue Pharma operates Purdue's branded prescription pharmaceutical business, which includes both opioid and nonopioid products. (Dkt. No. 91-4, at App.1244). OxyContin is one of Purdue Pharma's three principal branded opioid medications. (Id.). The other two are Hysingla and Butrans. (*Id.*). Purdue generated approximately \$34 billion in revenue total between 1996-2019, most of which came from OxyContin sales (See e.g., JX-2481); prior to bankruptcy, OxyContin accounted for some 91% of Purdue's U.S. revenue. (See JX-1984, at 40:24-41:5; JX-3275, at 338:6-9; JX-0999).

Purdue Pharma manufactures OxyContin for itself and, in limited quantities, for certain foreign independent associated companies ("IAC"), which are ultimately owned by the Sackler family. (Dkt. No. 91-4, at App. 1245). Purdue Pharma receives royalties from IACs' sales for OxyContin *40 abroad. (Id.). The IACs are not debtors in this case.

Until early 2019, members of the Sackler family served as directors of Purdue; the last Sackler's resignation from the Board became effective in the beginning of that year, although many family members stepped down during 2018.

II. The Sackler Family

Since Purdue was sold to brothers Arthur, Mortimer and Raymond Sackler in 1952 (see JX-1985, at 33:12-13), 13 the company has been closely held and closely run by members of the Sackler family, many of whom took on an active role in the company comparable to that of senior management prior to 2018. See In re Purdue Pharma L.P., No. 19-23649, 2021 WL 4240974, at *33 (Bankr. S.D.N.Y. Sept. 17, 2021). In large part due to the success of their pharmaceutical business. the Sackler family have long been ranked on Forbes' list of America's Richest Families, becoming one of the top twenty wealthiest families in America in 2015, with a reported net worth of \$14 billion dollars. (See JX-1985, at 40:24-42:10).

Mortimer Sackler's side of the family is known as "Side A," and Raymond Sackler's side is known as "Side B." (Dkt. No. 91-4, at App.1250). From approximately 1993 until 2018, there were always at least six or seven members of the Sackler family on the Board; independent directors never equaled or outnumbered the number of Sackler family directors on the Board. (See Confr. Hr'g Tr., Aug. 19, 2021, at 159:17-25, 22:5-9; Dkt. No. 91-4, at App.1345).

In addition to Purdue, certain members of the Sackler family served as directors of an entity called "MNP," later "MNC" ("MNP/MNC"), which operated as an advisory board for IACs worldwide, including for "specific pharmaceutical manufacturer IACs" and "corporations throughout the world that [the Sackler] family owns and that are in the ... pharmaceutical business." (*See* Confr. Hr'g Tr., Aug. 18, 2021, at 31:8-18; Confr. Hr'g Tr., Aug. 19, 2021, at 24:12-23). MNP/MNC's recommendations were typically followed by the IACs. (Confr. Hr'g Tr., Aug. 19, 2021, at 23:9-17).

A. Side A

Mortimer D. Sackler, who died in 2010, served as the cochief executive officer of Purdue with his brother Raymond until the end of his life. (JX-3275.0168-69; Dkt. No. 91-5, at App.2089).

Three of his seven children – Ilene Sackler Lefcourt, Kathe Sackler, and Mortimer David Alfons Sackler ("Mortimer D.A. Sackler") – sat on the Board of Purdue for nearly 30 years, until 2018. (Confr. Hr'g Tr., Aug. 19, 2021, at 19:13-20, 158:6-15; JX-3298.0037; Dkt. No. 91-5, at App.2089). They also served as officers of Purdue, with Mortimer D.A. and Ilene holding the title of vice president and Kathe the title of senior vice president. (Confr. Hr'g Tr., Aug. 19, 2021, at 19:21-25, 22:18-23:4, 158:16-21; JX-3298.0075; JX3275.0169).

Mortimer Sackler's wife Theresa Sackler also served on the Board of Purdue from 1993 until 2018, explaining that her "husband asked me to join ... it was a family company and he felt that family members should be on the board." (JX-3275.0034, 36; Dkt. No. 91-4, at App.1345).

All four – Ilene, Kathe, Theresa, and Mortimer D.A. Sackler – served as directors on the board of MNP/MNC for many years. (Confr. Hr'g Tr., Aug. 19, *41 2021, at 19:21-25, 22:18-23:4, 161:2-11; JX-3298.0080; JX-3275.0059).

B. Side B

Raymond Sackler, who died in 2017, served as co-chief executive officer of Purdue with his brother Mortimer D. Sackler. (*See* JX-3275.0168-69).

Raymond Sackler's wife and two sons served as Board members of Purdue. (*See* Dkt. No. 91-4, at App.1345). His sons, Jonathan and Richard Sackler, served from 1990 until

2018, and his wife Beverly Sackler from approximately 1993 until 2017. (*See id.*; Confr. Hr'g Tr., Aug. 18, 2021, at 30:6-8).

In addition to his role as director, Richard Sackler also served as president of Purdue from 2000-2003, co-chair of the Board from 2003-2007, and chair of the Board from approximately 2008 until 2010 or 2011. (Confr. Hr'g Tr., Aug. 18, 2021, at 30:6-22, 44:20-21). He served as a director of MNP/MNC until 2018 and has served as director of at least one IAC. (*Id.* at 31:23-32:19).

Richard Sackler's son David Sacker also served on the Board from 2012 until 2018 and as a director of MNP/MNC. (Confr. Hr'g Tr., Aug. 17, 2021, at 43:12-14, 44:6-13).

Finally, Mariana Sackler, Richard Sackler's daughter, held several roles within the "family business" (JX-1991, at 58:19-25), including working as a consultant in the "research and development department" of Purdue on OxyContin projects and a "PR" role at Mundipharma Italy, an IAC, advancing "information around topics about pain in Italy" and "marketing and selling OxyContin" there. (*Id.* at 30:4-18; 32:12-33:3; 58:19-64:25). Marianna has never been an officer or director of Purdue.

III. OxyContin

OxyContin is a synthetic opioid analgesic – a powerful narcotic substance designed to relieve pain. (*See JX-2181*; JX-2195.0048; JX-2195.0059). Opioid analgesics have been available for several decades to treat moderate to severe pain. (JX-2181; Dkt. No. 91-4, at App.1259). But until the early 1980's they were limited to immediate-release dosage forms. (JX-2181; *see JX-2199*). Immediate-release pain killers are less than ideal because they control pain for only 4-6 hours at a time; by contrast, a controlled-release pain killer can provide relief from serious pain for up to 12 hours at a time. (*See Dkt. No. 91-4*, at App.1259; JX-2181; JX-2199; JX-2185-0010).

In the early 1980's, Purdue developed its first controlled-release morphine drug which it marketed as "MS Contin" (also called "MSContin" and "MS-Contin"). (JX-2181; see JX-2199; JX-2180-0030, 0084). MS Contin solved many of the difficulties associated with immediate-release opioids, and it was marketed, largely without abuse, throughout the 1980's and 1990's. (JX-2180-0015, 0078; Dkt. No. 91-4, at App.1262). However, morphine's stigma as an addictive narcotic caused patients and physicians alike to avoid it. (See JX-2180-0030).

So Purdue concentrated on the research, development, and testing of a non-morphine drug: its controlled-release semisynthetic opioid analgesic named "OxyContin." (See JX-2181; JX-2199; Dkt. No. 91-4, at App.1261-62). In December 1995, the Food and Drug Administration ("FDA") approved OxyContin for use. (Id.). OxyContin's formulations were labeled as "extended release" or "time release" doses because the active ingredients continuously enter into a patient's system over time; a single dose could provide relief from serious pain for up to 12 hours. (See JX-2181). *42 A 2000 Time Magazine article explains that OxyContin was quickly "hailed as a miracle" after its introduction in 1995, because "it eases chronic pain because its dissolvable coating allows a measured does of the opiate oxycodone to be released into the bloodstream." (JX-2147).

For years, Purdue contended that OxyContin, due to its "time release" formulation, posed virtually no threat of either abuse or addiction – as opposed to other pain relief drugs, such as Percocet or Vicodin, which are not controlled-release painkillers. *See the Purdue Frederick Company, Inc.*, No. 1:07-cr-00029, Dkt. No. 5-1, at ¶20-27 ("Agreed Statement"); (Dkt. No. 91-4, at App.1268-1269). Purdue delivered that message to prescribing physicians and patients alike.

But time-release OxyContin proved to have an efficacy and safety profile similar to that of immediate-release opioid pain relievers. (*See* JX-2195.0027, 48-49, 59). Indeed, in 2001, the FDA required that Purdue remove from its drug label the claim that OxyContin had a very low risk of iatrogenic addiction; Purdue was ordered to add instead the highest level of safety warning that the FDA can place on an approved drug product. (*See* JX-2181; JX-2199; JX-2220).

IV. Purdue's Deceptive Marketing of OxyContin

To promote its new product OxyContin, Purdue launched an aggressive marketing campaign. (*See* JX-2153). That campaign was multi-fold, aiming in part to combat concerns about the abuse potential of opioids and to encourage doctors to prescribe OxyContin for more and different types of pain. (*See* Dkt. No. 91-4, at App.1268-1269; Agreed Statement, at ¶20; JX-2181.0002).

Before OxyContin, opioid pain relievers were usually prescribed for cancer patients and patients with chronic diseases whose pain was "undertreated." (See JX-2181.0002). But Purdue pushed OxyContin as a treatment for many types of pain patients, including those with "noncancer

pain" and other "nonmalignant" pain. (*Id.*; *see id.* at 0023, 0044). Purdue repeatedly published advertisements claiming, for example, that OxyContin can be an effective "first-line therapy for the treatment of arthritis" and safely used for "osteoarthritis pain" (JX-2218) and in many cases "mak[ing] unsubstantiated efficacy claims promoting the use of OxyContin for pain relief," "promoting OxyContin for a much broader range of patients with pain than are appropriate for the drug," "overstat[ing] the safety profile of OxyContin," and repeatedly omitting OxyContin's "abuse liability" (JX-2221) – all of which was contemporaneously documented in FDA warning letters to the company throughout the early 2000's. (*See, e.g.*, JX-2218; JX-2221).

By its marketing campaign, Purdue sought to eliminate concerns regarding "OxyContin's addictive potential." (See Agreed Statement, at ¶19-20; Dkt. No. 91-4, at App.1268-1269). To do this, Purdue needed to encourage doctors and patients to overcome their reservations about the use of opioids. For this purpose, Purdue created a website called "In The Face of Pain," which promoted OxyContin pain treatment and urged patients to "overcome" their "concerns about addiction." See Petition, State of Kansas, ex rel. Derek Schmidt, Attorney General v. Purdue Pharma L.P., et al., Case No. 2019-cv-000369, at ¶89 (Shawnee Cnty. Dist. Ct. May 16, 2019). Testimonials on the website were allegedly presented as personal stories of OxyContin patients who had overcome life-long struggles with debilitating pain, although they were allegedly written *43 by Purdue consultants who were paid to promote the drug. Id.

Purdue also allegedly distributed pamphlets to doctors. *Id.* at ¶33. In one such pamphlet, *Providing Relief, Preventing Abuse: A Reference Guide To Controlled Substance Prescribing Practices*, Purdue wrote that addiction "is not caused by drugs." *Id.* In another, the "Resource Guide for People with Pain," Purdue explained, "Many people living with pain and even some healthcare providers believe that opioid medications are addictive. The truth is that when properly prescribed by a healthcare professional and taken as directed, these medications give relief – not a 'high.'" *Id.* at ¶35.

Purdue's marketing campaign proved successful. OxyContin was widely prescribed; bonuses to Purdue sales representatives for the sale of OxyContin increased from \$1 million in 1996 to \$40 million by 2001; and by 2001, annual sales of OxyContin reached \$1 billion. (JX-2181.0007;

JX-2151). By 2001, OxyContin was "the most prescribed brand-name narcotic medication" in the U.S. (JX-2181.0002, 0007).

V. The Opioid Crisis

But OxyContin's popularity as a pain reliever coincided with the scourge of widespread abuse of the drug around the country. (See, e.g., JX-2147; JX-2148; JX-2149; JX-2180-0078; JX-2181). Many individuals who had been prescribed OxyContin by their doctors for legitimate pain conditions became addicted to the drug. (See JX-2181). And hundreds of thousands of seasoned addicts and novice drug abusers, including teenagers, quickly discovered that crushing an OxyContin tablet and then snorting or injecting it resulted in a quick "morphine-like high." (See JX-2148; JX-2149; JX-2183; JX-2195.0059).

By the early 2000's, rates of opioid addiction in connection with OxyContin use were skyrocketing throughout the country. (See JX-2147; JX-2148; JX-2149). In the early years, "remote, rural areas" were particularly hard hit, due in part to the fact that these areas are

home to large populations of disabled and chronically ill people who are in need of pain relief; they're marked by high unemployment and a lack of economic opportunity; they're remote, far from the network of Interstates and metropolises through which heroin and cocaine travel; and they're areas where prescription drugs have been abused though in much smaller numbers—in the past.

Foister v. Purdue Pharma, L.P., 295 F. Supp. 2d 693, 696 (E.D. Ky. 2003) (quotation and internal citation omitted).

However, the crisis was not limited to one type of community or part of the country. (See JX-2147). Pill mills opened in urban areas, as unscrupulous physicians began writing prescriptions for OxyContin to stooge purchasers (often drug addicts themselves), who were recruited to obtain and fill prescriptions, turning over the pills to drug dealers, who resold them on the street, making astronomical profits. (See JX-2175; JX-2176). This Court presided over the criminal trial of a doctor who ran such a pill mill in Hamilton Heights on the Upper West Side of Manhattan, through which he garnered millions of dollars in ill-gotten gains at the expense of desperate people who were addicted to OxyContin. See United States v. Mirilashvili, No. 14-cr-0810 (CM), Dkt. No. 1 (S.D.N.Y. Dec. 9, 2014).

Prosecutions like the one of Dr. Mirilashvili, coupled with enhanced regulatory oversight over both prescribers of opioids and pharmacies that had filled suspiciously high numbers of prescriptions, reduced the number of illicit prescriptions of OxyContin. *44 But drying up the source. did not end the problem of addiction. Individuals who had been feeding an OxyContin habit turned to alternative sources to get their fix - including street drugs like heroin and its even stronger and more lethal cousin, fentanyl, which is fast acting and 100 times more potent than morphine. (See JX-2195.0050-52). The recent increase in overdose deaths in this country is driven in significant part by the increasingly widespread use of fentanyl. (See Dkt. No. 91-4, at App. 1271).

In 2017, the U.S. Department of Health and Human Services ("DHHS") declared the opioid epidemic to be a national public health emergency. 14 According to the Centers for Disease Control and Prevention, from 1999 to 2019, nearly 247,000 people died in the United States from overdoses involving prescription opioids. 15 DHHS estimates the "economic burden" of prescription opioid misuse in the United States is between \$53-72 billion a year, including medical costs, lost work productivity, addiction treatment, and criminal justice costs. 16

Today, it is estimated that between 21-29% of patients who are prescribed opioids for chronic pain misuse them. 17 Between 8-12% of people who are using an opioid for chronic pain develop an opioid use disorder. Id. An estimated 4-6% of those who misuse prescription opioids transition to using heroin. Id. About 80% of people who use heroin first misused prescription opioids. Id. OxyContin, it seems, is the ultimate "gateway" drug.

VI. Pre-Bankruptcy Litigation Involving Purdue and Members of the Sackler Family

With the swelling opioid crisis, Purdue began to face inquiries about and investigations into OxyContin.

In 2000, the U.S. Attorney of Maine alerted the company to widespread abuse of the drug in rural Maine. (See JX-2151; JX-2180-0078; JX-2181). In 2001, the Attorney General of Virginia Mark Earley requested a meeting with company officials regarding widespread abuse of the drug in Virginia. (See JX-2151). By 2002, the then-Purdue spokesman Tim Bannon confirmed that there were federal investigations into Purdue's marketing of OxyContin. (Id.).

Two decades of litigation, both civil and criminal, ensued.

A. The First Round of Lawsuit: 2001-2007

By 2001, plaintiffs across the country had begun to file individual and class actions against Purdue in state and federal courts, including in the U.S. District Court for the Southern District of New York and in the Supreme Court of the State of New York. (*See e.g.*, JX-2181; Dkt. No. 91-5, at App.2037-2038). Members of the Sackler *45 family were not named as defendants in these lawsuits. (*See* Dkt. No. 91-5, at App.2040).

Plaintiffs in early cases plead a variety of theories of liability pursuant to which Purdue could be held liable as a result of its development, testing, manufacturing, distributing and marketing of OxyContin, including: negligence, strict product liability, failure to warn, breach of express and/or implied warranty, violation of state consumer protection statutes, conspiracy, fraud, and unjust enrichment. *See e.g.*, *Wethington v. Purdue Pharma LP*, 218 F.R.D. 577, 581 n. 1 (S.D. Ohio 2003).

Many of the early cases filed were class actions that sought certification of classes of people who had been prescribed OxyContin and suffered harm as a result. See e.g., Hurtado v. Purdue Pharma Co., No. 12648/03, 6 Misc.3d 1015A, 800 N.Y.S.2d 347, 2005 WL 192351, at **9-14 (Sup. Ct. Richmond Cnty. Jan. 24, 2005) (discussing cases). But given the stringent requirements for class certification, class certification motions in these cases were often denied. For example, in Foister v. Purdue Pharma L.P., plaintiffs in the Eastern District of Kentucky sought unsuccessfully to certify class of "all persons who have been harmed due to the addictive nature of OxyContin." No. Civ.A. 01-268-DCR, 2002 WL 1008608, at *1 (E.D. Ky. Feb. 26, 2002); see also Gevedon v. Purdue Pharma, 212 F.R.D. 333, 336 (E.D. Ky. Oct. 17, 2002) (denying class certification); Campbell v. Purdue Pharma, L.P., No. 1:02 CV 00163 TCM, 2004 WL 5840206, at *1 (ED Mo. June 25, 2004) (denying class certification). Class certification was generally deemed inappropriate because courts concluded that individual questions predominated ("addiction to the drug is an individualized question of fact"), thus precluding a finding of commonality. See Howland et al. v. Purdue Pharma, L.P. et al., 104 Ohio St.3d 584, 821 N.E.2d 141, 146-147 (Oh. Sup. Ct. Dec. 15, 2004). When such motions were granted, the decisions were often reversed. See id.

Absent class certification, the sheer number of individual cases that were filed meant that cases had to be sent to judicial coordinating panels. In New York, for example, five state cases were transferred to the New York Litigation Coordinating Panel in 2005 – after which 1,117 additional lawsuits were filed and coordinated. *See Hurtado*, 2005 WL 192351, at *15, 6 Misc.3d 1015(A), 800 N.Y.S.2d 347; *Matter of OxyContin*, 15 Misc.3d 388, 390, 833 N.Y.S.2d 357 (Sup. Ct. Richmond Cnty. 2007). Within these coordinated cases, after much discovery, settlements were pursued. *See e.g.*, *Matter of OxyContin II*, 23 Misc.3d 974, 975, 881 N.Y.S.2d 812 (Sup. Ct. Richmond Cnty. 2009) (discussing efforts in 2006-2007 to reach a "universal settlement" of the thousands of New York cases).

Discovery in these lawsuits proved useful to state and federal regulatory agencies *46 that were also investigating Purdue's role in the opioid crisis. Attorney Jayne Conroy, who testified at the Confirmation Hearing on behalf of the AHC, explained that the discovery taken by her firm in hundreds of New York cases against Purdue was later subpoenaed by the Justice Department as part of the federal government's 2006-2007 investigation into Purdue. (Dkt. No. 91-5, at App.2038-2039).

B. The 2007 Settlement and 2007 Plea Agreement

1. <u>Purdue's 2007 Settlements with 26 States and the District of Columbia</u>

In 2007, twenty-six states¹⁹ and D.C. settled investigations into Purdue's promotional and marketing practices regarding OxyContin for \$19.5 million ("2007 Settlement").²⁰ (Dkt. No. 91-4, at App.1269-70; *see* JX-2152). As part of the 2007 Settlement, Purdue entered into a consent judgment with each government party. (Dkt. No. 91-4, at App.1270); *see*, *e.g.*, Consent Judgment, *Washington v. Purdue Pharma L.P.*, Cause No. 07-2-00917-2 (Sup. Ct. Wash. Thurston Cnty. May 9, 2007), at Section I(M), ¶25 ("Consent Judgment").

Pursuant to the Consent Judgment, Purdue agreed to "establish, implement and follow an OxyContin abuse and diversion detection" ("ADD") program which "consist[ed] of internal procedures designed to identify potential abuse or diversion of OxyContin" for a minimum of ten years. (See Dkt. No. 91-4, at App.1270; Consent Judgment, ¶¶13-14). Purdue also agreed to submit "annual compliance

certifications to a multistate group of attorneys general for three years." (Dkt. No. 91-4, at App.1270).

In exchange for Purdue's payment and compliance, the settling States agreed to:

release[] and forever discharge[], to the fullest extent permitted by law, *Purdue and its past and present officers, directors, shareholders*, employees, co-promoters, affiliates, parents, subsidiaries, predecessors, assigns, and successors (collectively, the "Releasees"), of and from any and all civil causes of action, claims, damages, costs, attorney's fees, or penalties that the Attorney General could have asserted against the Releasees under the State Consumer Protection Law by reason of any conduct that has occurred at any time up to and including the Effective Date of this Judgment relating to or based upon the Subject Matter of this Judgment ("Released Claims").

(Consent Judgement, Section VI) (emphasis added). According to Judge Drain, these 2007 releases covered about seventy-seven members of the Sackler family. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *31. The release covered only claims that could have been asserted by the Attorneys General of the settling states; among the claims that were not released were: (1) private rights of action by consumers, (2) claims relating to best price, average wholesale price or wholesale acquisition cost reporting practices or Medicaid fraud or abuse; (3) claims asserting antitrust, environmental or tax liability; *47 (4) claims for property damage; (5) claims to enforce the terms and conditions of the judgment; and (6) any state or federal criminal liability that any person or entity, including Releasees, has or may have to the settling state.

Some of the states did not participate in this 2007 Settlement. Several had already entered into individual settlements with Purdue, while others entered into separate settlements subsequently. (See Dkt. No. 91-4, at App. 1270). For example, in 2002, Florida settled an investigation into Purdue for \$500,000 (id.); in 2004, West Virginia settled an action against Purdue for \$10 million (id.); in 2006, Mississippi settled its investigation into Purdue for \$250,000 (id.). In 2015, New York signed an assurance of discontinuance of its investigation in exchange for Purdue's payment of a \$75,000 penalty and certain promises, including ongoing implementation of the ADD program in New York and submission to annual reviews and monitoring by the Attorney General. Id.; In the Matter of Purdue Pharma L.P., Attorney General of the State of New York Assurance No. 15-151, at \P 8, 28, 38, 40, 49 (Aug. 19, 2015). In 2016, Kentucky settled an action against Purdue for \$24 million. (Dkt. No. 91-4, at App.1270). And in March 2019, Purdue agreed to pay the State of Oklahoma \$270 million to settle that state's opioid claims. (*Id.* at App.1278); *see* Consent Judgment, *Oklahoma v. Purdue Pharma et al.*, No. CJ-2017-816, § 4.1 (Dist. Ct. Cleveland Cnty. Mar. 26, 2019).

The releases in these separate cases generally extinguished the claims of the respective state against Purdue for opioid-related misconduct. For example, the West Virginia settlement released "any and all claims and demands" of the Attorney General of West Virginia (on behalf of the state and state agencies) against Purdue and its affiliates, shareholders, officers, directors, and others²¹ that were "sustained or incurred as a result of the manufacture, marketing and sale of OxyContin" in West Virginia. (See JX-2225). Similarly, the Oklahoma settlement released "any and all claims of any nature" of the Attorney General (the state and its subdivisions) against Purdue, its officers, directors, shareholders, direct and indirect owners, beneficiaries of the owners, and enumerated others, arising out of the conduct alleged in the complaint, including conduct related to the marketing and sale of opioids in Oklahoma. See Consent Judgment, Oklahoma v. Purdue Pharma et al., No. CJ-2017-816, §§ 1.1, 5.1, 5.2 (Dist. Ct. Cleveland Cnty. Mar. 26, 2019).

2. Purdue Frederick Company, Inc.'s 2007 Plea Agreement and Related Civil Settlements

Also in 2007, Purdue Frederick Company²² pled guilty to one felony count of misbranding OxyContin, with the intent to defraud or mislead, in violation of 21 U.S.C. §§ 331(a), 333(a) (2). (Dkt. No. 91-4, at App.1268-69; see JX-2153–JX-2168); see JX-1899. Purdue Frederick's President and CEO Michael Friedman, its Executive Vice President and Chief Legal Officer Howard R. Udell, and its Chief Scientific Officer Paul D. Goldenheim, in their capacity as corporate officers, each pled guilty to a misdemeanor charge of misbranding. *48 (Dkt. No. 91-4, at App.1268); see The Purdue Frederick Company, Inc., No. 1:07-cr-00029, at Dkt. Nos. 7-9.

As part of the Agreed Statement of Facts, the Purdue Frederick Company admitted that:

[b]eginning on or about December 12, 1995, and continuing until on or about June 30, 2001, certain PURDUE supervisors and employees, with the intent to defraud or mislead, marketed and promoted OxyContin as

less addictive, less subject to abuse and diversion, and less likely to cause tolerance and withdrawal than other pain medications ...

(Agreed Statement, at \$20; see Dkt. No. 91-4, at App.1268-1269).

As part of the 2007 Plea Agreement, Purdue Frederick agreed to pay over \$600 million dollars in fines and various other payments.²³ (Dkt. No. 91-4, at App.1269; JX-1899, at § 3). This included \$160 million to the United States and the states to settle various civil claims that had been asserted by governments - over \$100 million to the United States and over \$59 million to "Each state that elects to participate in this settlement ..." (JX-1899, at § 3(b)). In the federal government's settlement agreement, the United States and its various departments agreed to release "Purdue and its current and former directors, officers, employees, affiliates, owners, predecessors, successors and assigns from any civil or administrative monetary claim the United States has or may have" under federal statutes creating causes of action for civil damages or penalties, as well as from administrative actions under various federal departments and programs. (See id. at Dkt. No. 5-4, at § IIII). The participating states' settlement agreement and release were limited to Medicaid fraud claims:

release and forever discharge [the] Company and its current and former directors, officers, employees, affiliates, owners, predecessors, successors and assigns from any civil or administrative monetary claim that the State has or may have for any claim submitted or caused to be submitted to the State Medicaid Program for the Covered Conduct ...

See The Purdue Frederick Company, Inc., et al., No. 1:07-cr-00029, Dkt. No. 5-14, at § III(2)) (emphasis added).

All states except Kentucky opted into the federal settlement. *See id.* at Dkt. No. 141, at 5.

An additional \$130 million was set aside to settle private civil liability claims related to OxyContin. (*Id.* at § 3(d)). Ms. Conroy of the AHC testified in the Confirmation Hearing that her approximately 5,000 clients received a total of \$75 million out of this settlement fund. (Dkt. No. 91-5, at App.2039).

As part of the resolution of the criminal case, Purdue agreed to a five-year corporate integrity program with the DHHS, pursuant to which DHHS was to monitor Purdue's compliance with federal healthcare law. This monitoring period expired on July 30, 2012. (Dkt. No. 91-4, at App.1269); *49 see The

Purdue Frederick Company, Inc., No. 1:07-cr-00029, at Dkt. No. 5-5. In 2013, Purdue completed the corporate integrity program with no significant adverse findings. (Dkt. No. 91-4, at App.1269).

The Honorable James P. Jones approved the 2007 Plea Agreement in July of that year. *See The Purdue Frederick Company, Inc.*, No. 1:07-cr-00029, at Dkt. No. 77.

C. The Second Round of Lawsuits: 2014-2019

The 2007 Settlement and Plea Agreement were intended to resolve for all time issues relating to Purdue's misrepresentations about OxyContin. (Dkt. No. 91-5, at App.2039). The corporate integrity agreement with DHHS meant ongoing monitoring (see The Purdue Frederick Company, Inc., No. 1:07-cr-00029, at Dkt. No. 5-5), and the ADD program agreed to with the 26 states and D.C. was meant to create internal procedures that would identify and interrupt abuse or diversion related to OxyContin. (Consent Judgment, ¶14). Purdue, for its part, insisted in its Informational Brief before the Bankruptcy Court that it "accepted responsibility for the misconduct in 2007 and has since then strived never to repeat it." (Dkt. No. 91-4, at App.1268).

However, if Purdue's admissions in its 2020 Plea Agreement are believed, this purported acceptance of responsibility was a charade, and the oversight mechanisms built into the settlements were a conspicuous failure. Judge Drain found that the Sacklers had an "evident desire to continue to drive profits from the products' sale," *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *33, and as they did so, the opioid crisis not only continued, it worsened. (*See Dkt. No. 91-5*, at App.2039-2040; JX-2185). As Mortimer D.A. Sackler testified in the Confirmation Hearing, "overdose deaths ... continued to rise ... The overdose deaths kept going up and up." (Confr. Hr'g Tr. Aug. 19, 2021, at 52:7-12).

Starting in about 2014, new lawsuits began to be filed against Purdue concerning its promotion and marketing of OxyContin. (*See e.g.*, JX-2411). But this time, members of the Sackler family were named as defendants. (*See, e.g.*, Confr. Hr'g Tr. Aug. 16, 2021, at 69: 4-15).

1. The Federal Multi-District Litigation in the Northern District of Ohio

At the end of 2017, sixty-four federal cases that had been brought in nine districts across the country by various government entities (state, cities, and counties) against Purdue and other defendants - including pharmacies (like Rite Aid), pharmaceutical companies (like Johnson & Johnson), and pharmaceutical distributors (like McKesson Corporation) – were sent to coordinated multi-district litigation in the Northern District of Ohio ("Opioid MDL"). See IN RE: National Prescription Opiate Litigation, MDL-2804, Dkt. No. 1, at Schedule A. The cases in the Opioid MDL asserted a variety of claims against Purdue and others for their role in the opioid crisis, under theories of liability including: (1) public nuisance, (2) false representations, (3) unjust enrichment, (4) common law parens patriae, (5) negligence, (6) gross negligence, and (7) consumer protection act claims. (Dkt. No. 91-4, at App. 1276); see e.g., Complaint, County of San Joaquin, et al. v. Purdue Pharma L.P., et al., No. 2:17-cv-01485, Dkt. No. 1, Ex. 1 (E.D. Ca. May 24, 2017); Complaint, Everett v. Purdue Pharma LP et al., No. 2:17-00209, Dkt. No. 1-1 (W.D. Wa. Jan. 18, 2017).

The Opioid MDL was assigned to The Honorable Dan A. Polster. At the time of *50 Purdue's filing for bankruptcy, approximately 2,200 actions against Purdue related to the opioid crisis were pending before Judge Polster. (*See* Dkt. No. 91-4, at App.1273).

Judge Polster put the cases before him on a settlement track and litigation track and assigned a Special Master to assist in their management. (*See MDL Dkt. No. 2676*, at 3). Given "the immense scope of the opioid crisis" Judge Polster was "very active from the outset of [the] MDL in encouraging all sides to consider settlement." (MDL Dkt. No. 2676, at 11).

Within the litigation track, Judge Polster designated attorneys to coordinate discovery in related state and federal cases (MDL Dkt. No. 616) and issued a case management order meant to "facilitate, to the maximum extent possible, coordination with parallel state court cases." (MDL Dkt. No. 876, at ¶I(b)). Judge Polster ordered the establishment of a joint database of all prescription opiate cases filed in state and federal courts, so that information and documents could be tracked and discovery cross-noticed. (*Id.* at ¶¶III-V). Over 450 depositions were taken under the Opioid MDL umbrella, and over 160 million pages of documents were produced. (MDL Dkt. No. 2676, at 5; *see* Dkt. No. 91-4, at App.1276).

The extensive discovery in the Opioid MDL, and the discovery coordination it facilitated, revealed for the first time the involvement of certain members of the Sackler family in acts that Purdue had agreed not to commit as part of the 2007 Plea Agreement. Schedule A to the 2020 Plea Agreement - to which facts the corporation has stipulated, so they are deemed proved²⁴ – chronicles Purdue's extensive violation of the 2007 Plea Agreement, which began almost from the time the ink was dry on the papers. (See JX-2094.0006, 0015-18). Unable to deny what was apparent from the Opioid MDL discovery, the corporation admitted that Purdue had engaged in aggressive efforts to boost opioid sales, including: offering payments to induce health care providers to write more prescriptions of Purdue opioid products, offering "prescription savings cards" for health care providers to give patients to encourage them to fill prescriptions for opioids, and failing to maintain effective controls against diversion, which included failing to inform the United States Drug Enforcement Administration that health care providers flagged for abuse filled over 1.4 million OxyContin prescriptions. (Id.).

Evidence produced in discovery also "subjected the Sacklers to increasing scrutiny and pointed towards culpability of certain members of the family ..." (Dkt. No. 91-5, at App.2040). This evidence demonstrated that members of the Sackler family were heavily involved in decisions on how to market and sell opioids (see JX-2944-45, JX-2952, JX-3013-14, JX-1652). Certain Sacklers, notably Richard, Mortimer D.A., and Theresa, aggressively set and pushed sales targets for OxyContin that were higher than those recommended by Purdue executives (see Confr. Hr'g Tr., Aug. 18, 2021, at 84:2-6; Dkt. No. 91-4, at App.1350-51); accompanied sales representatives on "ride along" visits to health care providers to promote "the sale of Purdue's opioids" (Confr. Hr'g Tr., Aug. 18, 2021, at 70:2-7); approved countless settlements related to Purdue's culpable conduct (id. at 126:2-18); and oversaw sales and marketing budgets and corresponding upward trends in OxyContin prescribing. (Confr. Hr'g Tr., Aug. 19, 2021, at 106:15-109:6).

As discovery turned up evidence of the involvement of members of the Sackler *51 family in Purdue's misconduct, those family members were added as defendants in a number of cases pending against Purdue. For example, attorney Jayne Conroy testified that, as a result of information disclosed during the Opioid MDL discovery, she added the Sacklers as defendants in the lawsuits her firm was pursuing against Purdue in New York State Supreme Court. (Confr. Hr'g

Tr. Aug. 16, 2021, at 70:16-25; *see also* Dkt. No. 91-5, at App.2040). Peter Weinberger, another attorney with AHC, similarly acknowledged to the Bankruptcy Court that, "State complaints naming Sackler family members relied on MDL documents extensively." (Bankr. Dkt. No. 3449, at ¶¶ 36-37, 40).

2. State Multi-District Litigations

In addition to the Opioid MDL, over 390 parallel actions against Purdue proliferated in state courts, as well as in local courts in D.C., Puerto Rico, and Guam. (Dkt. No. 91-4, at App.1273). The causes of actions asserted in these various litigations included: (1) violations of state false claims acts; (2) violations of state consumer protection laws; (3) public nuisance; (4) fraud; (5) negligence; (6) unjust enrichment; (7) civil conspiracy; (8) violations of state controlled-substances acts; (9) fraudulent transfer; (10) strict products liability; and (11) wrongful death and loss of consortium. (*Id.*, at App.1276).

In some states, these lawsuits were consolidated in coordinated state proceedings. (*Id.* at App.1273-1274; *see e.g.*, Dkt. No. 91-5, at App.2039-2040). Such coordination occurred in Connecticut, Illinois, New York, Pennsylvania, Texas, and South Carolina. (Dkt. No. 91-4, at App.1273). In New York, cases brought by 58 counties and two dozen cities against Purdue were transferred to and coordinated in Suffolk County. (Dkt. No. 91-5, at App.2040).

While members of the Sackler family were not originally named as defendants in these state court coordinated actions, once their role in the marketing of OxyContin post-2007 was revealed in the Opioid MDL discovery, complaints in many state litigations were amended to name members of the Sackler family as defendants. (See, e.g., Dkt. No. 91-5, at App.2040; see Bankr. Dkt. No. 3449, at ¶¶ 36-37, 40). Specifically, Richard Sackler, Jonathan Sackler, Mortimer D.A. Sackler, Kathy Sackler, Ilene Sackler Lefcourt, Beverly Sackler, Theresa Sackler, Mariana Sackler, and David Sackler were named as defendants in various lawsuits. (See e.g., Dkt. No. 91-7, at App.2402-2597). In at least three of these cases, state courts denied the Sackler defendants' motions to dismiss the claims against them. (See Dkt. No. 94, at 5; Dkt. No. 91-5, At App.2041); see e.g., Order, In re Opioid Litigation, No. 400000/2017, Dkt. No. 1191 (Sup. Ct. Suffolk Cnty. June 21, 2019).

Thus, when Purdue filed for bankruptcy in September 2019, "... the threat of liability for at least some members of the [Sackler] family was real and [] without the protections of bankruptcy, individual family members were at risk of substantial judgments against them." (See Dkt. No. 91-5, at App.2040). As explained by the UCC in the Confirmation Hearing, it was estimated that "... litigating against the Sacklers could eventually lead to a judgment or multiple judgments greater than \$4.275 billion." (Bankr. Dkt. No. 3460, at 33; see also Bankr. Dkt. No. 3449, at ¶ 10).

3. The Renewed Lawsuits Against Purdue and Members of the Sackler Family by the Individual States

But private litigation was far from the only game in town. By the middle of 2019, forty-nine states' Attorneys General had filed new or amended lawsuits against Purdue, all of which named specific members of the Sackler family and/ or Sackler-related entities. (See App.1274); see e.g., *52 Amended Complaint, New York v. Purdue Pharma L.P., et al., No. 400016/2018 (Sup. Ct. Suffolk Cnty. Mar. 28, 2019). For example, in March 2019, the New York Attorney General amended its earlier complaint against Purdue to add claims against the same eight members of the Sackler family and various Sackler entities.²⁵ Id. at ¶814-900. The newlyasserted claims included claims for public nuisance, fraud, gross negligence, willful misconduct, unjust enrichment, fraudulent conveyances, violations of state finance laws and social services laws, and "repeated and persistent" fraud and illegality in violation of Executive Law § 63(12). Id. Against the "Sackler entities," the complaint asserted claims for unjust enrichment and fraudulent conveyance. Id.

The Attorneys General of all but one of the State Appellants – California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and D.C. – filed or amended complaints that include a range of charges against both Purdue and members of the Sackler family. (*See, e.g.*, Dkt. No. 103-7, at A-1553; Dkt. No. 95-1, at A0008; Dkt. No. 91-7, at App.2598; Dkt. No. 91-8, at App.2661; Dkt. No. 91-9, at App.3153; Dkt. No. 121-2, at MDA-008; JX-1647; JX-0946). The State of Washington did not assert claims against members of the Sackler family specifically but asserted claims against "Does 1 through 99" and "Doe Corporations 1 through 99" who – although not yet named – allegedly acted with Purdue "in committing all acts" in their complaint. (*See* Dkt No. 103-3, at App-630; JX-0944). This left open the possibility of naming members of the Sackler family and Sackler family entities.

The State Appellants' asserted claims included:

- fraudulent transfer (see e.g., Dkt. No. 91-7, at App. 2649; Dkt. No. 91-9, at App.3194);
- fraud and fraudulent misrepresentation (see e.g., Dkt. No. 91-9, at App.3184);
- unjust enrichment (see e.g., Dkt. No. 91-9, at App.3192; Dkt. No. 103-7, at A-1752; JX-1647.0199);
- negligence (see e.g., Dkt. No. 91-8, at App.2766; Dkt. No. 91-9, at App.3187; JX-0944.0123);
- public nuisance (see e.g., Dkt. No. 91-8, at App.2768-69; Dkt. No. 91-9, at App.3175; Dkt. No. 103-7, at A-1749; Dkt. No. 95-1, at A0068; JX-1647.0197; JX-0944.0120); and
- violation of state consumer protection statutes by deceptive and unfair acts and practices. (*see e.g.*, Dkt. No. 91-7, at App.2642-2648; Dkt. No. 91-8, at App.2764; Dkt. No. 103-7, at A-1746-47; Dkt. No. 95-1, at A0066-67; Dkt. No. 121-2, at MDA-110; JX-1647.0194; JX-0944.0118).

For example, California asserted two claims for violations of its False Advertising Law (Cal. Bus. & Prof. Code § 17500 et seq.), and Unfair Competition Law (Cal. Bus. & Prof. Code § 17200 et seq.), as well as a public nuisance claim (Cal. Civ. Code § 3494 et seq.), against Purdue and nine individual members of the Sackler family, including Mariana Sackler. (*53 Dkt. No. 95-1, at A0066-68; JX-0947). California sought, inter alia, the assessment of civil penalties against each defendant and an order directing Purdue and the Sacklers to abate the public nuisance.

Connecticut – the state where Purdue's headquarters are located – asserted four claims for violations of its Unfair Trade Practices Act (Conn. Gen. Stat. § 42-110a et seq.) and one claim for fraudulent transfer against Purdue and eight individual members of the Sackler family. (Dkt. No. 91-7, at App.2642-49; JX-0840). Connecticut sought, *inter alia*, civil penalties, restitution, and disgorgement from all defendants, including the Sacklers.

Delaware – where Purdue Pharma's limited partnership was formed – asserted three claims for violations of Delaware's Consumer Fraud Act (6 Del. C. § 2511 *et seq.*) as well as claims for negligence and public nuisance against seven

individual members of the Sackler family.²⁷ (Dkt. No. 91-8, at App.2764-2768; JX-0945; JX-1646). Delaware sought, *inter alia*, civil penalties and abatement.

Maryland asserted a claim for violation of the state's consumer protection laws (Md. Code Ann., Com. Law §§ 13-301 *et seq.*) against the same seven individual members of the Sackler family. (*See* Dkt. No. 121-2, at MDA-008). Maryland, like the other opposing states, sought civil penalties against the Sackler defendants, among other relief.

Oregon asserted three claims against Purdue and eight individual members of the Sackler family – the first seeking a declaratory judgment that Purdue and related entities are the alter egos of the Sacklers and that the state may pierce the corporate veil; the other two asserting claims for fraudulent conveyance. (See JX-1647). Oregon sought, inter alia, a judgment restraining the Sackler defendants from disposing of property and ordering a return of the conveyed funds.

Rhode Island asserted six claims against Purdue and the eight individual members of the Sackler family for public nuisance, fraud and fraudulent misrepresentation, fraudulent and voidable transfers, violations of Rhode Island's State False Claims Act (R.I. Gen. Laws § 9-1.1-1 *et seq.*), negligence, and unjust enrichment. (Dkt. No. 91-9, at App.3175-94; JX-1648; JX-2214). Rhode Island sought, *inter alia*, civil penalties, treble damages, disgorgement, and restitution.

Vermont asserted four claims against the eight individual members of the Sackler family: two violations of the Vermont Consumer Protection Act (9 V.S.A. § 2451 *et seq.*), unjust enrichment, and public nuisance. (Dkt. No. 103-7, at A-1746-52; JX-1649). Vermont also sought civil penalties, among other relief.

Washington State brought an action against Purdue, "Does 1 through 99," and "Doe Corporations 1 through 99" for violating the Washington's Consumer Protection Act (Wash. Rev. Code § 19.86), for causing a public nuisance, and for breaching *54 Washington's common law of negligence. (JX-0944). The Complaint sought abatement, restitution, and statutory penalties, among other relief.

D.C. brought two claims against Purdue and Richard Sackler for violations of its consumer protection statutes (D.C. Code § 28-3904(f)). (See JX-0946). D.C. sought, like the others

and among other relief, statutory civil penalties against each defendant.

Each State Appellant filed its claims before Purdue filed for bankruptcy in September 2019. None of the cases had been litigated to judgment. (See Dkt. 91-4, at App.1278). These cases were not subject to the automatic stay that stopped private litigation in its tracks once Purdue filed, (11 USCA § 362(b)), but the Bankruptcy Court preliminarily enjoined all litigation against Purdue and the Sacklers; that order was affirmed by this court, In re Purdue Pharms. L.P., 619 B.R. 38 (S.D.N.Y. 2020). As a result, no activity has taken place in any of these lawsuits since shortly after Purdue's filing.

4. Lawsuits in Canada

In Canada, a number of class actions were filed against certain of the Debtors with allegations similar to those made in the U.S. (See Dkt. No. 91-4, at App.1273, 1477; see e.g., Dkt No. 98-1, at 13-102, 113-202). Prior to Purdue's Chapter 11 filing, the lead plaintiffs in ten of the Canadian class actions settled their claims for \$20 million, and Purdue Pharma (Canada) ("Purdue Canada")²⁹ placed that amount in trust pending approval of the settlement by the Ontario Superior Court of Justice, the Superior Court of Quebec, the Supreme Court of Nova Scotia and the Saskatchewan Court of Queen's Bench (the "Canadian Settlement"). (Dkt. No. 91-4, at App. 1477-1478). The Canadian Settlement, once approved and after funds are disbursed, "completely and unconditionally released, forever discharged, and acquitted [the Debtors] from any and all Settled Patient Claims against the Debtors and from any other Proof of Claim or portion thereof in respect of any Settled Patient Claim filed against any Debtor." (Id.). Under the Canadian Settlement, no member of the Canadian classes party to that settlement can recover from any source other than the Canadian Settlement trust, and every class member in a settling class bears the burden of proving in the U.S. bankruptcy that its claim was not released and discharged by the Canadian Settlement. (*Id.*).

However, the Canadian Settlement did not cover the claims of the Canadian Appellants, which are Canadian municipalities and indigenous tribes. The Canadian Appellants' lawsuits concerned sales and distribution of OxyContin in Canada, affecting Canadian communities, by Purdue Canada, which the Canadian Appellants assert was controlled by Sackler family members. (Dkt. 98, at 5; Bank. Dkt. No. 3421, at 89-92). The Canadian Appellants' lawsuits against Purdue

Canada assert, *inter alia*, claims for conspiracy, public nuisance, negligence, fraud, and unjust enrichment. (Dkt No. 98-1, at 18-19). The Canadian Appellants also stated at oral argument that that they "were barred by *55 the imposition of the stay and the stay-related orders" – the preliminary injunction described above – "from actually naming [certain] Competition Act claim[s] against the Sacklers and the [Shareholder Released Parties]," which they would assert if given the opportunity. (Oral Arg. Tr., Nov. 30, 2021, at 80:11-16).

The Canadian Appellants do not include the Canadian federal government or any Canadian province – all of whom seem to be content with the fact that the Plan excludes claims against Purdue Canada. (See Plan, at 10). Indeed, the ten Canadian provinces for their part seem to believe their claims are excluded and have decided to pursue their claims in Canada instead. For example, in press on the topic, Reidar Mogerman, counsel for the British Columbia government, explained that the provinces gave up their claims (worth US\$67.4 billion) before the Bankruptcy Court in the U.S. to protect lawsuits they filed against Purdue's Canadian entities. 30 "We didn't want to get swallowed in competition with the U.S. claims and lose our Canadian claims," he explained to the press. Id. To date, in Canada, the various Canadian provinces have asked the Ontario Superior Court of Justice to continue to pursue their separate class actions against Purdue Canada. Id.

VII. Members of The Sackler Family Insulate Themselves Against Creditors

As Judge Drain found, the evidence indicates members of the Sackler family distributed significant sums of Purdue money to themselves in the years 2008-2016, during which time those Sackler family members were closely involved in the operations of Purdue and aware of the opioid crisis and the litigation risk. See In re Purdue Pharma L.P., 2021 WL 4240974, at *32. As detailed below, this "aggressive[]" (to use Richard Sackler's word, see JX-1703) pattern of distribution of earnings to shareholders represented a sharp departure from prior practice in two ways.

First, during the period 1996-2007, Purdue up-streamed on average 9% of its revenue per year to the Sacklers; but during the period 2008-2016, Purdue up-streamed on average 53%, and as much as 70%, of its revenue to the Sacklers. (*See* JX-2481).

Second, during the earlier period (1996-2007), the Sacklers kept less than 10% of the money that was distributed by Purdue for themselves, while using over 90% of those distributions to pay taxes on Purdue's earnings; but during the years between 2008-2016, the Sacklers retained, in one form or another, 56% of those distributed earnings, while using just 44% to pay taxes. (Bankr. Dkt. 3410-2).

The 2008-2016 distributions to shareholders also contrasted with the practices of Purdue's peer pharmaceutical companies. (*See* JX 1703).

According to the Sacklers' own expert, this pattern of upstreaming corporate earnings substantially depleted Purdue's treasury during that eight-year period. (JX-0431, p. 77, Fig. 10).

A. The Sacklers Cause the Transfer of Billions of Dollars from Purdue to Themselves

In March 2007, Richard, Jonathan, Kathe, and Mortimer Sackler exchanged emails noting that the "future course [for the business] is uncertain" (JX-2976) and identified the "emergence of numerous new lawsuits" as a "risk[] ... we're not *56 really braced for." (JX-2957). Just a few months later, in May, shortly after the 2007 guilty plea and settlement, David Sackler emailed Jonathan Sackler, Richard Sackler, and their financial advisor, expressing concern about the family's personal liability for the opioid crisis: "what do you think is going on in all of these courtrooms right now? We're rich? For how long? Until suits get through to the family?" (JX-2237; see also JX-2096, at ¶ 161). In his deposition, David Sackler agreed that his May 17, 2007, email reflects "concern[] that the family would be sued in connection with Purdue's sale of OxyContin." (JX-1989, at 183:14-184:20, 187:18-188:20). Less than a week after David Sackler sent his email, Richard and Jonathan Sackler met with a bankruptcy attorney, though Purdue was not in debt and not at risk of bankruptcy. (See JX-2985; JX-2986).

Thereafter, on July 26, 2007, a family financial advisor sent a confidential memorandum to Jonathan Sackler, in which he advised that Purdue faced "[u]ncapped liabilities" that posed "a huge valuation question" for Purdue at that very moment – the moment when the Plea and settlements were ostensibly ending any illegal behavior and putting further corporate liability – and potential shareholder liability – in the rear view mirror. (JX-1660, at 2-3). He added, "I presume the family has taken most of the appropriate defensive measures." (*Id.* at 3; *see also* JX-2241). One such measure, proposed in a separate

memorandum, was "to distribute more free cash flow so [the owners] can purchase diversifying assets." (JX-2254; see also JX-2096, at ¶ 162).

By January 2008, the anxiety over impending lawsuits was apparent; Richard Sackler emailed Mortimer Sackler that, "I've been told by Silbert that I will be [sued] and probably soon." (JX-3001). Mortimer Sackler lamented in a later email in February 2008 that he wished to get out of the pharmaceutical business altogether "given the horrible risks, outlooks, difficulties, etc." (Bankr. Dkt. No. 2161, at Ex. 67). In this vein, in April 18, 2008, Richard Sackler warned in a memo that the business posed a "dangerous concentration of risk" and proposed that the family either sell the company or "distribute more free cash flow" to themselves. (JX-2214, ¶ 86; JX-3004; JX-3104). The family chose the latter course.

Beginning in 2008, Purdue began to make significant cash distributions to and for the benefit of the Sacklers. (JX-1988, at 226:13-19 (deposition of Richard Sackler); Confr. Hr'g Tr., Aug. 19, 2021, at 149:6-14 (testimony of Mortimer D.A. Sackler); Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17 (testimony of Richard Sackler); see also Dkt. No. 91-4, at App.1544). As noted above, about 44% of the money distributed went to pay taxes; a small fraction was invested in the IACs, which were owned by the Sacklers; and the rest went to Rosebay and Beacon, the Side A and B Sackler family trusts. (See JX-1987, at 156:8-158:4; Confr. Hr'g Tr., Aug. 19, 2021, at 27:7-28:1-12).

In the years leading up to the 2007 Plea Agreement and Settlement, the Sackler family had been content to leave most of Purdue's earnings in the company, except insofar as was necessary to pay taxes. In response to a question from this Court, Debtors acknowledged that, between January 1, 1995 and December 31, 2007, distributions to the Sacklers totaled \$1.322 billion, of which \$1.192 billion (or 90.2%) was used to pay taxes. (Dkt. No. 177; see JX-3050.0042; JX-2481; Bankr. Dkt. 3410-2). In the twelve years prior to 2008, the Sacklers took personal distributions from Purdue that averaged 9% of Purdue's revenue. (See JX-2481).

*57 After 2007, Purdue went from distributing less than 15% of its revenue to distributing as much as 70% of revenue. ³¹ (*Id.*). It also jumped from distributing approximately 38% of its free cash flow in 2006 to distributing 167.4% of free cash flow in 2007 and continued to distribute free cash flow in the 90% range for the next decade. (*Id.*). These distributions totaled approximately \$10.4

Billion. (*See* Dkt. No. 91-4, at App.1544; Bankr. Dkt. No. 3410-1, at ¶ 12; Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17 (testimony of Richard Sackler); Confr. Hr'g Tr., Aug. 19, 2021, at 27:7-28:1-12, 149:6-14 (testimony of Mortimer D.A. Sackler)).

Approximately \$4.6 billion of that amount was used to pay pass through taxes (*see* Bankr. Dkt. 3410-2), which attests to the tremendous profitability of Purdue's OxyContin business during that same eleven-year period. In fact, the vast majority of Purdue's earnings between 2008-2017 came from OxyContin sales. (*See* JX-1984, at 40:24-41:5; JX-3275, at 338:6-9; JX-0999).

According to the Sacklers' own expert, the change in distribution pattern drained Purdue's total assets by 75% and Purdue's "solvency cushion" by 82% between 2008 and 2016. (JX-0431, p 77, Fig. 10). Richard Sackler later acknowledged in an email in 2014 that, "in the years when the business was producing massive amounts of cash, the shareholders departed from the practice of our industry peers and took the money out of the business." (JX 1703). In at least one email in 2014, Jonathan Sackler referred to this distributing of cash flow from OxyContin as a "milking" program. (JX-2974).

The obvious implication of this evidence was recognized by Judge Drain in his bankruptcy decision, discussed infra in Background Section XII. See In re Purdue Pharma L.P., 2021 WL 4240974, at *27, 31, 32-33. In particular, Judge Drain noted, "I do have an extensive report and trial declarations as to the nature of the assertedly over \$11 billion of avoidable transfers, when they occurred, what they comprised, and who they were made to," id. at 31; and found, "The record suggest[s] that at least some of the Sacklers were very aware of the risk of opioid-related litigation claims against Purdue and sought to shield themselves from the economic effect of such claims by causing Purdue to make billions of dollars of transfers to them and to shield their own assets, as well, from collection." Id. at 32. While he made no finding that these distributions qualified as fraudulent conveyances, or that they could be recouped by Purdue, Judge Drain also acknowledged that the estate had potential claims of "over \$11 billon of assertedly avoidable transfers." Id. at 27.

As Judge Drain also acknowledged, the distribution of Purdue money to the Sackler family occurred during a time when members of the Sackler family, including those named in many pending cases, were closely involved in the operations of Purdue and well aware of the opioid crisis and the litigation

risk. He said, "The testimony that I heard from the Sacklers tended to show, that as a closely held company Purdue was run differently than a public company and that its Board and shareholders took a major role in corporate decision-making, including Purdue's practices regarding its opioid products that was more *58 akin to the role of senior management." Id. at 33. As Richard Sackler acknowledged in the Confirmation Hearing, he oversaw as director "many settlements," stating, "I was director, and I cannot count up all the settlements that the company entered into while I was a director. But there were many settlements, both private and public." (Confr. Hr'g Tr., Aug. 18, 2021, at 126:2-18). For example, as part of the Board, he approved the settlement of \$24 million to the State of Kentucky to resolve unlawful and unfair deceptive trade practice allegations against Purdue in 2015. (Id. at 124:16-125:1).

The Sacklers vehemently deny any suggestion that any of these transfers would qualify as fraudulent conveyances. (See JX-2096, at ¶G). However, in Addendum A to the 2020 "Settlement Agreement" with the DOJ, the Government asserted its confidence that it could prove that: "From approximately 2008 to 2018, at the Named Sacklers' request, billions of dollars were transferred out of Purdue as cash distributions of profits and transfers of assets into Sackler family holding companies and trusts. Certain of these distributions and transfers were made with the intent to hinder future creditors and/or were otherwise voidable as fraudulent transfers." (Id. at Addendum A, ¶6; see also id. at ¶¶158-159)

The fact of these extensive transfers of money out of Purdue and into the family coffers is not contested. For example, during the Confirmation Hearing, when Richard Sackler was asked if it were "true that during that time period generally [2008-2018] ... the Purdue Board of Directors transferred out billions of dollars to Sackler family trusts or holding companies," he answered, "Yes ... yes, that we did." (Confr. Hr'g Tr., Aug. 18, 2021, at 65:8-17). Only whether those transfers (or any of them) would qualify as fraudulent conveyances is in dispute. But while that presents an important and interesting question, I agree with Judge Drain that it was not one he needed to resolve in order to rule on the confirmability of the Plan. But at some point – certainly by 2018 – Purdue itself was in a precarious financial position in face of the lawsuits. At the time of the bankruptcy filing, Purdue represented that, while it had "no funded debt and no material past due trade obligations" - or even any "judgment creditors" - "the onslaught of lawsuits has proved unmanageable" and "will result only in the financial

and operational destruction of the Debtors and the immense value they could otherwise provide ..." (Dkt. No. 91-4, at App.1237).

B. A Pre-Petition Settlement Framework Is Proposed That Would Release the Sackler Family From Liability.

In the months before Purdue filed for bankruptcy, Purdue, the Sackler family (now no longer represented on Purdue's Board) and Sackler entities were engaged in discussions about a potential framework for settlement of all claims against Purdue and the Sacklers with "the various parties in the MDL litigation" and certain "subgroups" of creditors and potential creditors. (*See* Confr. Hr'g Tr., Aug. 12, 2021, at 152:23-153:22). John Dubel testified in the Confirmation Hearing³² that the pre-petition settlement framework discussions involved the concept of third-party releases *and* the concept of using the bankruptcy *59 process to release all claims against the Sacklers in exchange for their contribution of funding to the settlement. (*Id.* at 154:1-5). Mr. Dubel explained:

[I]t was very clear from the ... Sacklers that if they were going to post up X amount of dollars – and I believe at the time, the settlement framework was somewhere around \$3 billion or so – that they were going to seek broad third party releases, and releases from the Debtors, releases of all the estate claims, etc., so that they could be able to put all of that – all of the litigation behind them ... it was something that was a prerequisite or a condition to them posting the amount of money that was in the settlement framework and then ultimately what is in the plan of organization we were seeking approval of.

(*Id.* at 155:25-156:1-12; *see id.* at 209:1-4, 214:8-19) (emphasis added).

So the Sacklers made it clear well before the Debtors filed for chapter 11 bankruptcy that they would contribute toward Purdue's bankruptcy estate only if they received blanket releases that would put "all of the litigation behind them." (*Id.* at 155:25-156:1-12). This was reported heavily in the press at the time of the bankruptcy filing. ³³

This pre-petition settlement framework was then imported into the bankruptcy process. As Mr. Dubel testified, once a pre-petition settlement framework was created, the plan was to "Us[e] the Chapter 11 process to enable us to then organize all of the various claimants into one group under ... the auspices of the Chapter 11 bankruptcy process." (*Id.* at

154:14-18). He further explained that, "It was the framework that would help us continue to bring all of the various creditor groups towards a decision as to whether it was better to litigate against the Sacklers or attempt to come up with a settlement that would be fair and equitable for all the creditors of the Debtor's estates." (*Id.* at 155:2-9). He testified that some 24 states "were supportive of us moving forward in the process of filing a Chapter 11 and using this [bankruptcy] as a means of coalescing all the parties into one organized spot to address the potential claims that the estates would have against the Sacklers." (*Id.* at 157:4-9).

Purdue's bankruptcy was thus a critical part of a strategy to secure for the Sacklers a release from any liability for past and even future opioid-related litigation without having to pursue personal bankruptcy. David Sackler acknowledged as much in his testimony, "I don't know of another forum that would allow this kind of global solution, this kind of equitable solution for all parties." (Confr. Hr'g Tr., Aug. 17, 2021, at 35:4-6).

VIII. The Underlying Bankruptcy

Facing the mounting lawsuits against both Purdue and members of the Sackler family in the U.S. and abroad, certain U.S. based Purdue entities (Debtors) filed for bankruptcy relief on September 15, 2019. (Bankr. Dkt. No. 1). Members of the Sackler family and the Sackler entities – such as Rosebay and Beacon – did not file for *60 bankruptcy, despite having been named as defendants in opioid-related lawsuits.

A. Pending Actions Against Purdue and Members of the Sackler Family Are Halted

Purdue quickly moved on September 18, 2019, before the Bankruptcy Court for an injunction halting all actions against Purdue as well as "against their current and former owners (including any trusts and their respective trustees and beneficiaries), officers, directors, employees, and associated entities." (Dkt. No. 91-4, at App.1471, 1562). This meant enjoining over 2,900 actions against Purdue and at least 400 civil suits against the Sacklers. (*Id.*, at App.1562).

Purdue argued that enjoining all litigation was necessary to facilitate the parties' work towards a global settlement in a single forum – the Bankruptcy Court. After an evidentiary hearing, on October 11, 2019, the Bankruptcy Court temporarily halted all such litigation until November 6, 2019 (*Id.* at App.1472), at which point it granted Purdue's motion

enjoining all plaintiffs from continuing or commencing any judicial, administrative, or investigative actions, as well as any other enforcement proceeding, against Purdue or the non-debtor related parties, including against members of the Sackler family. (*Id.*; see Bankr. Dkt., No. 2983, at 171). This Court affirmed the Bankruptcy Court's grant of the preliminary injunction. *Dunaway v. Purdue Pharma. L.P.* (*In re Purdue Pharma. L.P.*), 619 B.R. 38 (S.D.N.Y. 2020). The expiration date of the preliminary injunction has been extended 18 times, during which period the parties negotiated to come up with the Plan. (*See* Dkt. No. 91-4, at App.1402, 1429, 1472-73; Bankr. Dkt. Nos. 2897, 2488).

B. The Creditor Constituencies in the Bankruptcy

On September 27, 2019, the U.S. Trustee appointed nine creditors to the UCC, an independent fiduciary to represent the interests of all unsecured creditors in the Purdue bankruptcy. (Dkt. No. 91-1, at App.7).³⁴ The UCC's appointees are Blue Cross and Blue Shield Association; CVS Caremark Part D Services L.L.C. and CaremarkPCS Health, L.L.C.; Cheryl Juaire; LTS Lohmann Therapy Systems, Corp.; Pension Benefit Guaranty Corporation; Walter Lee Salmons; Kara Trainor; and West Boca Medical Center. (Bankr. Dkt. No. 1294; see Dkt. No. 115-1, at 5). The UCC also has several ex-officio, non-voting representatives: (i) Cameron County, Texas, on behalf of the MSGE; (ii) the Chevenne and Arapaho Tribes, on behalf of certain Native American Tribes and Native American-affiliated creditors; and (iii) Thornton Township High School District 205, on behalf of certain public school districts. (See Bankr. Dkt. No. 1294).

Between September and November 2019, various other creditor groups were formed to represent creditor constituencies in the bankruptcy, including as follows:

- The AHC was formed in September 2019 and is comprised of ten States, six counties, cites, parishes, or municipalities, one federally recognized American Indian Tribe (the Muscogee (Creek) Nation, as well as the court-appointed Co-Lead Counsel on behalf of the Plaintiffs' Executive Committee in the Opioid MDL (see Bankr. Dkt. No. 279);
- NAS Children was formed in September 2019 and is comprised of around 3,500 children, who born with "neonatal abstinence syndrome" due *61 to exposure to opioids in utero, and/or their guardians (see Bankr. Dkt. No. 1582; Dkt. No. 115-1, at 3);

- The PI Ad Hoc Group was formed in October 2019 and is comprised of 60,761 personal injury claimants, each holding "one or more unsecured, unliquidated, opioidrelated personal injury claims against one or more of the Debtors" (see Bankr. Dkt. Nos. 3939, 348);
- MSGE was formed in October 2019 and is comprised of 1,317 entities: 1,245 cities, counties and other governmental entities, 9 tribal nations, 13 hospital districts, 16 independent public school districts, 32 medical groups, and 2 funds across 38 states and territories (see Bankr. Dkt. No. 1794);
- The Ad Hoc Group of Non-Consenting States ("NCSG") was formed in October 2019 and is comprised of 25 states that did not reach a pre-petition agreement with Purdue or the Sacklers regarding "the general contours of a potential chapter 11 plan" to settle their claims California, Colorado, Connecticut, Delaware, D.C., Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin (see Bankr. Dkt. No. 296);
- The Ratepayer Mediation Participants ("Ratepayers")
 was formed in October 2019 and is comprised
 of "proposed representatives of classes of privately
 insured parties who are plaintiffs and proposed class
 representatives in their individual and representative
 capacities in suits brought against [Purdue]" in 25
 actions in 25 states (see Bankr. Dkt. No. 333; Dkt. No.
 91-3, at App.1108); and
- The Ad Hoc Group of Hospitals ("Hospitals") was formed in November 2019 and is comprised of hundreds of hospitals that have treated and treat patients for conditions related to the use of opiates manufactured by Purdue (see Bankr. Dkt. 1536).

Other groups that formed during the pendency of the bankruptcy proceedings include:

- The Third-Party Payor Group ("TPP Group"), comprised of certain holders of third-party payor claims (see Dkt. No. 91-3, at App.1114);
- The Native American Tribes Group ("Tribes Group"), comprised of the Muscogee (Creek) Nation, the Cheyenne & Arapaho Tribes, an ex officio member of

the Creditors' Committee, and other Tribes represented by various counsel from the Tribal Leadership Committee and the Opioid MDL Plaintiffs' Executive Committee (see id. at App.1096); and

• The Public School District Claimants ("Public Schools"), comprised of over 60 public school districts in the United States (see id. at App.1106; Bankr. Dkt. Nos. 2707, 2304).

Each of these groups was representative of certain creditor constituencies, whose "members" (there was no certified class) held similar types of claims against Purdue.

C. The Court Sets A Bar Date for Filing of Proof of Claims On January 3, 2020, Purdue filed a "Motion for Entry of an Order (I) Establishing Deadlines for Filing Proofs of Claim and Procedures Relating Thereto, (II) Approving *62 the Proof of Claim Forms, and (III) Approving the Form and Manner of Notice Thereof" (the "Bar Date Motion")." (See Dkt. No. 91-4, at App.1475). On February 3, 2020, the Bankruptcy Court approved the Bar Date Motion, setting June 30, 2020 as the deadline for all persons and entities holding a prepetition claim against Purdue, as defined in section 101(5) of the Bankruptcy Code (a "Claim"), to file a proof of claim. (Id.). On June 3, 2020, the Bankruptcy Court entered an order extending the Bar Date to July 30, 2020. (Id.; see id. at App.1298).

During the five months while the window for filing proofs of claims was open, over 614,000 claimants did so. Just 10% of the claims so filed would give rise to over \$140 trillion in aggregate liability – more than the whole world's gross domestic product. (Dkt. No. 91-4, at App.1421; see Dkt. No. 91-1, at App.28). 35 The claimants included the federal government, states and political subdivisions, Native American Tribes, hospitals, third-party payors, ratepayers, public schools, NAS monitoring claims, ³⁶ more than 130,000 personal injury victims, and others. (See Dkt. No. 91-4, at App.1425-1429; see Dkt. No. 91-1, at App.28).

D. The Court Approves Mediation and Appoints Mediators to Facilitate Resolution

On February 20, 2020, Purdue filed an unopposed "Motion for Entry of an Order Appointing Mediators," seeking the appointment of mediators and mandating that the various creditor constituencies participate in mediation. (Dkt. No. 91-4, at App. 1486). On March 2, 2020, the Bankruptcy Court

approved Purdue's motion and appointed The Honorable Layn Phillips (ret.) and Mr. Kenneth Feinberg as co-mediators (Id.; Bankr. Dkt. No. 895). Both are among the most experienced and respected mediators in the country.

IX. The Negotiation of the Bankruptcy Plan

Through mediation, Purdue and stakeholders worked to negotiate a complex settlement framework that would ultimately direct the Debtors' assets and \$4.275 billion from the Sackler families toward abating the opioid crisis and restoring victims of the crisis. (See Dkt. No.91-4, at App.1402, 1429; see Bankr. Dkt. 2488).

The parties involved in the negotiations included the Debtors and non-debtor related parties (i.e., members of the Sackler family) and the various creditor constituencies. Together, as defined in the court's mediation order, the participating "Mediation Parties" were the Debtors, the UCC, the AHC, the NCSG, the MSGE, the PI Ad Hoc Group, NAS Children, the Hospitals, the TPP group, and the Ratepayers. (Dkt. No. 91-4, at App.1486). The Tribes Group, the Public Schools, the National Association for the Advancement of Colored People, and others also participated in mediation, although not as official Mediation Parties. (Id.; see Bankr. Dkt. No. 2548).

The mediation progressed in three phases (id. at App.1404), as follows:

*63 A. Phase 1: March 2020-September 2020

Phase one of the mediation addressed "the allocation of value/proceeds available from the Debtors' Estates" as disputed between the "Non-Federal Public Claimants" (the states, federal districts and U.S. territories, political subdivisions, and Native American tribes) and "Private Claimants" (hospitals, private health insurance carriers and third-party payors, and individuals and estates asserting personal injury, including NAS Children). (Dkt. No. 91-4, at App.1487; Bankr. Dkt. No. 855, at 6-7). It proceeded with a "series of rigorous formal mediation sessions during the period from March 6, 2020 to September 11, 2020." (Dkt. No. 91-4, at App.1487).

The mediation resulted in certain resolutions (see generally Bankr. Dkt. 1716), the most critical of which included value allocation between and among the various parties, such as:

First, the Non-Federal Public Claimants agreed that all value received by them through the Chapter 11 Cases would be exclusively dedicated to programs designed to abate the opioid crisis ...

Second, the Non-Federal Public Claimants addressed and resolved ... value allocation for all Native American Tribes ... and a default mechanism that, in the absence of a stand-alone agreement between a State or territory and its political subdivisions, provides a structure and process for applying funds to abate the opioid crisis ...

Third, agreement was reached on written term sheets with certain individual Private Claimant groups that addressed allocation of estate value to each Private Claimant group. These agreements provided, among other things, that each class of Private Claimants will receive fixed cash distributions over time, the values and time periods varying for each class. Moreover, the Ad Hoc Group of Hospitals, the Third-Party Payors, and the NAS Committee (with regard to medical monitoring) each agreed to dedicate substantially all the distributions from their respective Private Creditor Trusts to abate the opioid crisis.

(See Dkt. No. 91-4, at App.1487). Ultimately, all participants except "the public school districts and the NAS children physical injury group" were able to achieve "agreement inter se as to their respective allocations as a result of the mediation process." (Bankr. Dkt. 2548, at 8).

Each of the term sheets with the private plaintiffs was conditioned on the confirmation of a plan of reorganization that includes participation by the Sackler Families in the plan of reorganization. (Bankr. Dkt. 1716, at 5).

However, not all issues were resolved. On September 23, 2020, while phase one of the mediation had reached "substantial completion" (Bankr. Dkt. 2548), the mediators' report indicated that "there remain terms to be negotiated by the parties with respect to each of the term sheets in order to reach final agreements ..." (Bankr. Dkt. 1716, at 5-6). With several open terms and the estate claims still to be negotiated, on September 30, the Bankruptcy Court entered a Supplemental Mediation Order, authorizing further mediation to resolve the open issues and to mediate the estate claims (phase 2). (Dkt. No. 91-4, at App.1551; Bankr. Dkt. Nos. 1756).

B. Phase 2: October 2020-January 31, 2021

The Bankruptcy Court's Supplemental Mediation Order authorized the mediators "to mediate any and all potential claims or causes of action that may be asserted by the estate or any of the Non-Federal Public *64 Claimants" against the Sackler families and entities "or that may otherwise become the subject of releases potentially granted to" members of the Sackler families and entities (defined as the "Shareholder Claims"). (See Bankr. Dkt. Nos. 1756, at 2; 2584, at 1; 518, at 4). This Order also "narrowed the number of mediating parties on the Shareholder Claims aspect of the mediation" to the Debtors, the UCC, the "Consenting Ad Hoc Committee," 37 the NCSG, the MSGE, and representatives of the Sacklers. (Bankr. Dkt. Nos. 2584, at 1; 2548, at 2).

In phase two, the mediators received presentations from the parties on their positions regarding the estate claims, including a presentation by the UCC of its "views and findings on its investigation of estate causes of action." (Dkt. No. 91-4, at at App.1551-52; Bankr, Dkt. No. 2584). 38 After the presentations, "numerical negotiation began," with offers and counteroffers proposed. However, no "mutually agreed resolution" was reached among all constituencies before the end of the phase two on January 31, 2021. (Bankr. Dkt. No. 2584).

C. Phase 2 Negotiations Continue with the Sackler families: January 2021 to March 2021

Although court-ordered mediation formally ended on January 31, 2021, settlement negotiations continued among the Sackler families and entities, the Debtors, the NCSG, the UCC, the ACH, and the MSGE regarding the "Sackler contribution" to the Debtors' estate. (See Bankr. Dkt. No. 2584, at 9; Dkt. No. 91-4, at App.1552-53). Eight more offers and counteroffers were exchanged between the end of January 2021 and February 18, 2021. (Dkt. No. 91-4, at App. 1553).

Ultimately, the Sackler families and entities, the Debtors, the AHC, the "Consenting Ad Hoc Committee," and the MSGE reached an agreement in principle, which settled on a guaranteed amount that the Sackler families would be required to contribute to the Debtors' estate – \$4.275 billion over nine years (or ten years if certain amounts were paid ahead of schedule in the first six years). (Id. at App. 1552-53; see Bankr. Dkt. Nos. 2488, 2879). The principal consideration for this payment was the "Shareholder Release" that was to be included in the Debtors' plan of reorganization. (See Bankr. Dkt. 2487, at § 10.8). That plan, along with the Debtors' "Disclosure Statement" containing the "Sackler Settlement

Agreement Term Sheet" reached in negotiation, were filed with the Bankruptcy Court on March 15, 2021. (*See* Bankr. Dkt. Nos. 2487, 2488).

D. Phase 3: May 7, 2021-June 29, 2021

Phase three of the mediation involved a final push to resolve the dispute of the *65 NCSG³⁹ over the terms of the agreement reached in phase two of the mediation between and among the Sackler families and entities, the Debtors, the AHC, the "Consenting Ad Hoc Committee," and the MSGE. (Bankr. Dkt. Nos. 2820, 2879). To that end, on May 7, 2021, the Bankruptcy Court asked his colleague, the Honorable Shelley C. Chapman, to preside over a mediation between the NCSG and the Sackler Families with respect to the terms of the settlement. (Bankr. Dkt. No. 2820). Between May 7 and June 29, 2021, Judge Chapman conducted 145 telephone meetings and several in-person sessions between the NCSG and the Sackler families and entities. (See Bankr. Dkt. No. 3119).

The result of the mediation was a modified shareholder settlement with the Sackler families and entities, which was agreed to in principle by a fifteen of the twenty-five nonconsenting states – specifically, Colorado, Hawaii, Idaho, Illinois, Iowa, Maine, Massachusetts, Minnesota, Nevada, New Jersey, New York, North Carolina, Pennsylvania, Virginia, and Wisconsin. (*Id.* at 2). Those states that reached agreement in principle also agreed to support and/or not object to the Plan.

The remaining non-consenting states – most of which are parties to this appeal – did not agree to the revised settlement. (*Id.*).

The new terms of the settlement included additional payments of \$50 million by the Sackler families, and the acceleration of another \$50 million in previously agreed settlement payments, resulting in total payments of \$4.325 billion. In addition to the money, Judge Chapman induced the parties to agree to several non-monetary terms; specifically, a "material expansion of the scope of the public document repository" to be established under the Plan, and certain prohibitions on Sackler family demands for naming rights in exchange for charitable contributions, together with a few other, minor concessions. (*See* Bankr. Dkt. No. 3119). ⁴⁰ The Shareholder Release was unchanged. (*See id.*).

On July 7, 2021, Purdue filed the mediator's report in the bankruptcy proceeding, informing Judge Drain of the result of the mediation.

X. Confirmation of the Plan: Summary of the Order on Appeal

Purdue filed the first version of the Plan on March 15, 2021. (Bankr. Dkt. No. 2487). It has subsequently filed twelve amendments to the Plan, the last of which was dictated by Judge Drain as a condition of confirmation. (*See* Bankr. Dkt. No. 3787).

On August 9, 2021, the Confirmation Hearing began before the Bankruptcy Court (Dkt. No. 91-3, at App.651), a six-day event during which 41 witnesses testified (by declaration or otherwise), after which the parties engaged in extensive oral argument. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *2.

*66 On September 1, 2021, the Bankruptcy Court rendered an oral ruling, stating it would confirm the proposed plan provided certain changes were made to it, the most relevant of which for purposes of this appeal was a modification of the Section 10.7 Shareholder Release:

I ... require that the shareholder releases in paragraph 10.7(b) [the release of third-party claims against the shareholder released parties], by the releasing parties, be further qualified than they now are. To apply [only] where ... a debtor's conduct or the claims asserted against it [are] a legal cause or a legally relevant factor to the cause of action against the shareholder released party.

(Confr. Hr'g Tr., Sept. 1, 2021, at 134:18-135:2); see also In re Purdue Pharma L.P., 2021 WL 4240974, at *45; see Plan, at § 10.7(b) (modifying the Plan in accordance with Judge Drain's instructions). Purdue filed the final version of the Plan the next day (Bankr. Dkt., No. 3726), and on September 17, 2021, Judge Drain issued his edited written decision confirming the Plan.

The salient features of the Plan are as follows:

Trusts to Administer Abatement and Distribution. Under the Plan, the majority of Purdue's current value will be distributed among nine "creditor trusts" that will fund opioid abatement efforts and compensate personal injury claimants, including the National Opioid Abatement Trust ("NOAT"), which will make distributions to qualified governmental entities. (Bankr. Dkt. No. 3456, at ¶¶ 5-6). Most of the creditor trusts are

abatement trusts and may only make distributions for the purpose of opioid abatement or to pay attorneys' fees and associated costs. (Id. ¶¶ 5-6). Two trusts – the "PI Trust" and "PI Futures Trust" – are the only exceptions: those creditor trusts will make distributions to qualifying personal injury claimants. (Id.)

The Public Document Repository. Under the Plan the Debtors are required to create a public document repository of Purdue material available for public review. (Bankr. Dkt. No. 3440, at ¶ 7.) The AHC testified at the Confirmation Hearing that the establishment of this public document repository was among their highest priorities. (Confr. Hr'g Tr., Aug. 13, 2021, at 151:17-152:9 ("[O]f all the aspects of ... the injunctive relief part of [the Plan], [the public document repository] ... is extremely important from the standpoint of, not only what it is that we developed in terms of evidence, [but also] lessons to be learned from the conduct that was uncovered and revealed."); Confr. Hr'g Tr., Aug. 16, 2021, at 83:20-22, 84:12-23 ("[I]it could be that the document repository is actually the most valuable piece of this settlement.")). The public document repository will be hosted by an academic institution or library and will include more than 13,000,000 documents (consisting of more than 100,000,000 pages) produced in the chapter 11 case and tens of millions of additional documents, including certain documents currently subject to the attorney client privilege that would not have been produced in litigation. (Bankr. Dkt. No. 3440, at ¶ 7.) The Plan ensures that scholars and the public can have access to all of these materials.

Purdue Pharma Will Cease to Exist. Under the Plan, Purdue Pharma will cease to exist. Its current business operating assets will be transferred to and operated by a new entity, known as "NewCo" in the Plan (Plan, at 28), but to be named KNOA. (Oral Arg. Tr., Nov. 30, 2021, at 158:1-17). NewCo will be governed by a board of five or seven disinterested and independent managers initially selected by the AHC and the MSGE, in consultation with the *67 Debtors and UCC, subject to a right of observation by the DOJ. (Plan, at § 5.4). NewCo will manufacture products, including Betadine, Denokot, Colace, magnesium products, opioids and opioidabatement medications, and oncology therapies. (See Oral Arg. Tr., Nov. 30, 2021, at 157:19-159:23). Additionally, NewCo will continue the Debtors' development of opioid overdose reversal and addiction treatment medications, and it must deliver millions of doses of those medications at low or no cost when development is complete (these will be distributed to groups or entities to be determined postemergence). (Id. at 159:19-160:7). NewCo will be subject to an "Operating Injunction" that prohibits it from, among other things, promoting opioid products and providing financial incentives to its sales and marketing employees that are "directly" (but not indirectly) based on sales volumes or sales quotas for opioid products. (Bankr. Dkt. No. 3456, at ¶10). It also is subject to "Governance Covenants" that ensure that NewCo provides all its products in a "safe manner," complies with settlement obligations, pursues public health initiatives, and follows pharmaceutical best practices. (Id. at ¶11). The Plan provides for the appointment of a monitor to ensure that NewCo complies with the Operating Injunction and Governance Covenants; the monitor will provide the public with regular updates and seek relief from the Bankruptcy Court to the extent necessary to carry out the monitor's obligations. (Id. at ¶13). Above all, NewCo is not intended to operate indefinitely: The Plan instruct the managers to use reasonable best efforts to sell the assets of NewCo by December 21, 2024. (Id. at ¶15).

Shareholder Settlement Agreement. The Plan incorporates the "Shareholder Settlement Agreement" and the transactions contemplated therein whereby, in exchange for the release of third-party claims against over 1,000 individuals and entities related to the Sackler family ("Shareholder Released Parties"), the Sackler family will give \$4.275 billion toward the Purdue estate. (Plan, at 37; Dkt. No. 91-3, at App.1042, 1045-1046, 1050).

Section 10.7(b) of the Plan sets out the terms of the release that the Sacklers, from the inception of the bankruptcy and earlier, insisted on in exchange for contributing funds to Purdue's estate. The Plan "releases and discharges" certain claims that third parties (including states and personal injury claimants) have asserted or might in the future assert against the Shareholder Released Parties. The release of claims against the Shareholder Released Parties permanently enjoins third parties from pursuing their current claims against the Shareholder Released Parties and precludes the commencement of future litigation against any of the Sacklers and their related entities, as long as (i) those claims are "based on or related to the Debtors, their estates, or the chapter 11 cases," and (ii) the "conduct, omission or liability of any Debtor or any Estate is the legal cause or is otherwise a legally relevant factor." (Plan § 10.7(b)). The third-party releases under the Plan are non-consensual; they bind the objecting parties as well as the parties who consented. All present and potential claims connected with OxyContin and other opioids would be covered by the Section 10.7 Shareholder Release.

Channeling Injunction. Under the Plan, all enjoined claims against the Debtors and those against the Shareholder Released Parties are to be channeled to the nine creditor trusts for treatment according to the trust documents of each respective trust ("Channeling Injunction"). (Plan, at p. 10 and § 10.8). However – as the U.S. Trustee points out, and the Debtors do not contest (see Dkt. No. 91, at 19-20; Dkt. No. 151, at 23-24) – the claims against the Shareholder Released Parties are effectively *68 being extinguished for nothing, even though they are described as being "channeled." (See e.g., Oral Arg. Tr., Nov. 30, 2021, at 37:9-14; 29:16-17). The U.S. Trustee explains that the Plan documents expressly prohibit value being paid based on causes of action (whether pre-or post-petition) against the Sackler family or other nondebtors for opioid-related claims. (Dkt. No. 91, at 19-20; see, e.g., Dkt. No. 91-2, at App.333 ("Distributions hereunder are determined only with consideration to a Non-NAS PI Claim held against the Debtors, and not to any associated Non-NAS PI Channeled Claim against a non-Debtor party.") (emphasis added); id. at App.392 ("Distributions hereunder are determined only with consideration to an NAS PI Claim held against the Debtors, and not to any associated NAS PI Channeled Claim against a non-Debtor party.") (emphasis added); id. at App.433 ("A Future PI Claimant may not pursue litigation against the PI Futures Trust for any Future PI Channeled Claim formerly held or that would have been held against a non-Debtor party.") (emphasis added)). And to assert any third-party claim against the trust, the claimant must have filed a proof of claim in the bankruptcy prior to the bar dates, but each of the bar dates passed by the time anyone was notified of the claims' extinguishment. (Dkt. No. 91, at 20). And to get an exception for an untimely filing, a party must proceed through multiple steps, after which the Bankruptcy Court – which serves as a gatekeeper – determines, in its discretion, that the untimely claim qualified under the Plan and granted leave to assert the claim. (Id.).

Debtors sidestepped the Plan's effective extinguishment of purportedly channeled third-party claims in its brief by not addressing the U.S. Trustee's points; they made no effort to clarify this in oral argument for the Court. (*See* Dkt. No. 151, at 23-27).

XI. Objections to the Plan

On June 3, 2021, the Bankruptcy Court approved Purdue's disclosure statement. (*See* Bankr. Dkt., No. 2988).

On July 19, 2021, the U.S. Trustee objected to confirmation of the Plan, arguing that the Section 10.7 Shareholder Release was unconstitutional, violates the Bankruptcy Code, and is inconsistent with Second Circuit law. (*See* Bankr. Dkt. No. 3256). Eight states – California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Washington, Vermont – and D.C. all filed objections, as did the City of Seattle, four Canadian municipalities, two Canadian First Nations and three *pro se* plaintiffs. (Bankr. Dkt. No. 3787, at 28; *see also* Bankr. Dkt. No. 3594). The U.S. Attorney's Office for this District on behalf of the United States of America filed a statement of interest supporting these objections to the Section 10.7 Shareholder Release. (*See* Bankr. Dkt. No. 3268).

The objectors argued, *inter alia* and as applicable to them, that the Section 10.7 Shareholder Release (1) violates the third-party claimants' rights to due process, (2) violates the objecting states' sovereignty and police power, (3) is not permitted under the Bankruptcy Code, and (4) the Bankruptcy Court lacks constitutional, statutory, and equitable authority to approve the Section 10.7 Shareholder Release.

XII. Judge Drain's Decision to Confirm the Plan

Judge Drain's opinion is a judicial *tour de force* – delivered from the bench only days after the end of a lengthy trial, it included extensive findings of fact and addressed every conceivable legal argument in great detail. Sixteen days later, on September 17, the learned bankruptcy judge *69 filed a written version of that oral decision, running to 54 pages on Westlaw, which is the version summarized here. *See In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. Sept. 17, 2021).

Judge Drain began by describing the highly unusual and complex nature of the situation before him – a "massive public health crisis," with a potential creditor body that included "every person in the range of the Debtors' opioid products sold throughout the United States" – individuals, local, state and territorial governments, Indian tribes, hospitals, first responders, and the United States itself. *Id.* at 58. He noted that over 618,000 claims, in an amount exceeding two trillion dollars, had been filed in the bankruptcy. And he commended the parties for working in "unique and trailblazing ways to address the public health crisis that underlies those claims." *Id.*

In his opening remarks, Judge Drain also addressed the elephant in the room:

These cases are complex also because the Debtors' assets include enormous claims against their controlling shareholders, and in some instances directors and officers, who are members of the Sackler family, whose aggregate net worth, though greater than the Debtors', also may well be insufficient to satisfy the Debtors' claims against them and other very closely related claims that are separately asserted by third parties who are also creditors of the Debtors.

Id.

Judge Drain then announced the ultimate result:

First, he concluded that there existed no other reasonably conceivable means to achieve the result that would be accomplished by the Plan in addressing the problems presented by this case. Second, he found that well-established precedent - which he described as "Congress in the Bankruptcy Code and the courts interpreting it" – authorized him to confirm the Plan. Id. Insofar as is relevant to this appeal, 41 Judge Drain reached the following conclusions.

A. The Section 10.7 Shareholder Release and Settlement with the Sacklers

The meat of this case, both before Judge Drain and on this appeal, is the Bankruptcy Court's approval of the broad releases that the Plan affords to all members of the Sackler family and to their related entities, including businesses and trusts.

The Plan includes two settlements with every member of the Sackler family – whether or not that individual had anything to do with the management of Purdue or personally exercised any control over Purdue - and with a variety of entities related to the Sacklers, including various trusts, businesses, and IACs. Taken together these individuals and entities (not all of whom have been or apparently can *70 be identified) are known as the "Shareholder Released Parties." Id. at 82-83.

The first settlement disposed of claims that the Debtors could assert against the Shareholder Released Parties for the benefit its creditors. Id. These included claims for (1) breach of fiduciary duty against those members of the Sackler family who were involved in - indeed, who drove - the business decisions that were the basis for Purdue's criminal and civil liability, and (2) fraudulent conveyance arising out of the Sackler family's removal of nearly \$11 billion from the Debtor corporations over the course of a decade. See id. at 90-92.

The second settlement disposed of certain third-party claims that could not be asserted by the Debtors against the Shareholder Released Parties, but were particularized to others. Chief among these claims are claims asserted by the states - both the consenting states and the objecting states - arising under various unfair trade practices and consumer protection laws that make officers, directors and managers who are responsible for corporate misconduct personally liable for their actions. Judge Drain did not review on a state-by-state basis the various state laws applicable to these objector claims, including laws that might forbid insurance coverage or indemnification and contribution claims by those individuals, such that their personal assets are very much at risk. Id. at 107-108.

In exchange for these releases, the Shareholder Released Parties agreed to contribute \$4.325 billion to a fund that would be used to resolve both public and private civil claims as well as both civil and criminal settlements with the federal government. Id. at 84-85. The Sacklers also agreed to the dedication of two charities worth at least \$175 million for abatement purposes; to a resolution that barred them from insisting on naming rights in exchange for charitable contributions; to refrain from engaging in any business with NewCo and to dispose of their interest in the non-U.S. Purdue entities within seven years; to certain "snap back" provisions that were designed to ensure the collectability of their settlement payments; and to the creation of an extensive document repository that would archive in a comprehensive manner the history of the Debtors and their involvement in the development, production and sale of opioids. *Id*.

Judge Drain made three fundamental findings relating to these settlements: that the Sackler Settlements were necessary to the Plan; that they were fair and reasonable; and that it was necessary and appropriate for him to approve the nonconsensual release of certain third-party claims against the Sacklers, even though they are not debtors.

B. The Sackler Settlements Were Necessary

Judge Drain concluded that these settlements were necessary to the Plan. He noted that a variety of other settlements that were essential components of the Plan - including agreedupon allocations of the pot of money to be created by the Debtors' estate and the Sackler contribution - would unravel for lack of funding if the Sacklers did not make their \$4.325 billion contribution. And he found that they would not make

that contribution unless they obtained broad releases from past and future liability. *Id.* at 105-07.

1. The Sackler Settlements Were Fair and Reasonable in Amount

- [4] Judge Drain evaluated the fairness of the settlement in light of the factors laid out by the Second Circuit in *71 *Motorola Inc. v. Official Committee of Unsecured Creditors & JP Morgan Chase Bank, N.A. (In re Iridium Operating LLC),* 478 F. 3d 452, 464-66 (2d Cir. 2007), which is controlling law in this Circuit on the questions. He made the following findings:⁴²
- (a) The Sackler settlements were the product of armslength bargaining conducted by able counsel in two separate mediations presided over by three outstanding mediators and preceded by what he described as the "most extensive discovery process not only I have seen after practicing bankruptcy law since 1984 and being on the bench since 2002, but I believe any court in bankruptcy has ever seen." *In re Purdue Pharma L.P.*, 633 B.R. at 85-86. That process led to the production of almost 100 million pages of documents, through which all interested parties could learn "anything suggesting a claim against the shareholder released parties." *Id.*
- (b) The settlements were negotiated by exceedingly competent counsel who were, as a result of the discovery process described above, well-informed about both the claims they might bring against the Shareholder Released Parties and the difficulties they would have in pursuing those claims. *Id.* at 86-88.
- (c) Purdue's creditors overwhelmingly supported the settlement. *Id.* at 87-88. Some 120,000 votes were cast on the Plan a number far exceeding the voting in any other bankruptcy case. *Id.* at 60-61. Over 95% of those voting in the aggregate favored the Plan: over 79% of the states and territories supported the Plan; over 96% of other governmental entities and tribes; and over 96% of the personal injury claimants; together with a supermajority of all other claimants. *Id.* at 87-88.
- (d) The failure to approve the settlement was likely to result in complex and protracted litigation, with attendant cost and delay, while the settlement offered significant and immediate benefits to the estate and its creditors. *Id.* at 87-89.

- [5] (e) Judge Drain focused particularly on the difficulty of collecting any judgments that might be obtained against the Sacklers. Id. at 88-89. Ordinarily this factor would rest on things like the paucity of assets available to satisfy judgments. But in this case the problems with collection were the result of what the Sacklers did with the money that they admittedly took out of the corporations between 2008-2016. The assets of family members are held principally in purportedly spendthrift trusts located in the United States and offshore - many of them on the Bailiwick of Jersey and many of those assets cannot readily be liquidated. As Judge Drain correctly observed, spendthrift trusts can and often do insulate assets from the bankruptcy process. And while generally applicable law governing U.S. trusts allows those trusts to be invaded when they are funded by fraudulent conveyances, there is a substantial question whether the same is true under Jersey law. Additionally, he noted that many Sackler family members live abroad, raising a barrier to an American court's acquiring personal jurisdiction over them. Although the learned bankruptcy judge did not reach any final conclusion about these complicated issues, he readily drew the conclusion that collectability presented a significant concern, one that was obviated by the settlement.
- *72 (f) Judge Drain also noted that the cost and delay attendant to the pursuit of the Sacklers which was in and of itself substantial would be compounded by the unraveling of the other settlements that were baked into the Plan. Judge Drain concluded that the unraveling of the Plan would inevitably result in the liquidation of Debtors under Chapter 7, which would in turn lead to no recovery for the unsecured creditors (including the personal injury plaintiffs), and no money for any abatement programs. *Id.* at 89-90. This conclusion was reinforced by the fact that, absent confirmation of the Plan, the United States would have a superpriority administrative expense claim in an amount (\$2 billion) that would wipe out the value of Purdue's business as a going concern (\$1.8 billion). *Id.* at 74-75.
- (g) Finally, Judge Drain considered the legal risks of the estates' pursuit of claims against the Sacklers against the benefits of settlement. *Id.* at 90-93.

Judge Drain first chronicled the problems Purdue would have in proving that the admitted conveyances qualified as fraudulent. He noted that over 40% of the purportedly avoidable transfers were used to pay federal and states taxes associated with Purdue, none of which was going to

be refunded. *Id.* at 90-91. He identified various technical defenses that the Sacklers could assert to fraudulent conveyance claims, including statutes of limitations and the impact of prior settlements. *Id.* at 91-92. And while admitting that at least some of the Sacklers appeared to have been very much aware of the risk of opioid litigation to Purdue's solvency and their own, he also pointed to evidence that Purdue may not have been "insolvent, unable to pay its debts when due, or left with unreasonably small capital" – which would be necessary to make a conveyance fraudulent – until as late as 2017 or 2018, by which time most or all of the conveyances had been made. *Id.*

As for alter ego, veil-piercing and breach of fiduciary duty claims, Judge Drain noted that most of the Sackler family members had nothing to do with Purdue's operations, and that no one had identified any action taken by any of them in their capacity as passive shareholders that would make them liable on such claims. *Id.* He also identified the extensive government oversight of Purdue after its 2007 Plea Agreement and Settlement with the federal government and certain states, and the fact that neither DHHS nor various state reviews ever identified any improper actions. *Id.* at 92-93. ⁴³

Judge Drain made no findings about the actual merit of any of the estates' claims against any member of the Sackler family. But weighing these difficulties against the benefits that would be derived from the settlement, he concluded:

I believe that in a vacuum the ultimate judgments that could be achieved on the estates' claims ... might well be higher than the amount that the Sacklers are contributing. But I do not believe that recoveries on such judgments would be higher after taking into account the catastrophic effects on recoveries that would result from pursuing those claims and unravelling the plan's intricate settlements. And as I said at the beginning of this analysis, there is also the serious issue of problems that would be faced in *73 collection that the plan settlements materially reduce.

Id.

Judge Drain ended his discussion of the *Iridium* factors with a deeply personal reflection – dare I say, a *cri de coeur* – that is perfectly understandable coming from one who had labored so long and so hard to try to achieve a better result. Admitting that he had "expected a higher settlement," he said:

This is a bitter result. B-I-T-T-E-R. It is incredibly frustrating that the law recognizes, albeit with some exceptions, although fairly narrow ones, the enforceability

of spendthrift trusts. It is incredibly frustrating that people can send their money offshore in a way that might frustrate U.S. law. It is frustrating, although a long-established principle of U.S. law, that it is so difficult to hold board members and controlling shareholders liable for their corporation's conduct.

It is incredibly frustrating that the vast size of the claims against the Debtors and the vast number of claimants creates the need for this plan's intricate settlements. But those things are all facts that anyone who is a fiduciary for the creditor body would have to recognize, and that I recognize.

Id.

Ultimately, however, the learned bankruptcy judge decided that the perfect was the enemy of the good:

I am not prepared, given the record before me, to risk [the parties'] agreement. I do not have the ability to impose what I would like on the parties.

Id. at 94. And so, albeit with obvious reluctance, he concluded that the settlement was reasonable as that term is understood at law

2. The Section 10.7 Shareholder Release Was In all Respects Legal

Having concluded that the settlements were fair and reasonable in amount, Judge Drain went on to address a number of challenges to his legal authority to impose the most controversial element of those settlements: The Section 10.7 Shareholder Release. *Id.* at *35. He rejected each such challenge.

Subject matter jurisdiction. First, Judge Drain concluded that he had subject matter jurisdiction to impose the third-party releases and injunctions. Citing *Celotex Corp. v. Edwards*, 514 U.S. 300, 307-08, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995) and *SPV OSUS, Ltd. v. UBS AG*, 882 F. 3d 333, 339-40 (2d Cir. 2018), he held that he had the undoubted power to enjoin the claims of third parties that had "any conceivable effect" on the Debtors' estates as part of a Bankruptcy Court's "related to" jurisdiction, conferred by Congress in 28 U.S.C. § 1334(b). *In re Purdue Pharma L.P.*, 633 B.R. at 95-98. He concluded that the third-party claims covered by the Section 10.7 Shareholder Release would directly affect the *res* of the Debtors' estates in three different ways: insurance rights, the Shareholder Released

Parties' right to indemnification and contribution, and the Debtors' ability to pursue its own overlapping claims against the Sacklers. He concluded by saying, "Depending on the kinds of third-party claims covered by a plan's release and injunction of such claims, I conclude, therefore, that the Court has jurisdiction to impose such relief, based upon the effect of the claims on the estate rather than on whether the claims are 'derivative ..." Id. at 98 (emphasis added).

Due process. Next, Judge Drain concluded that the Section 10.7 Shareholder Release did not violate the third-party *74 claimants' right to due process. Id. at 97-99. He rejected the argument that a release constitutes a de facto adjudication of the claim, holding that such a release "is part of the settlement of the claim that channels settlement funds to the estate." Id. at 98. And he held that claimants had been provided with constitutionally sufficient notice of the proposed releases. Uncontroverted testimony that Judge Drain found credible established that messages tailored to reach persons who may have been harmed by Debtors' products had reached roughly 98% of the adult population of the United States and 86% of the adult population of Canada, with supplemental notice reaching an estimated 87% of all U.S. adults and 82% of Canadian adults, as well as audiences in 39 countries, with billions of hits on the internet and social media in addition to notice delivered by TV, radio, publications, billboards and outreach to victim advocate and abatement-centered groups. While references contained in the notices sent readers to complex lawyerly descriptions of the release provisions, the notices themselves were written in plain English and specifically mentioned that the Plan contemplated a broad release of civil (not criminal) claims against the members of the Sackler family and related entities.

Constitutional authority. Judge Drain next concluded that he had constitutional power to issue a final order confirming a plan that contains a third-party claims release. *Id.* at 99-100. He determined that a proceeding to determine whether a chapter 11 plan containing such a release was a "core" proceeding, so ordering the non-debtor releases and enjoining the prosecution of third-party claims against non-the Sacklers qualified as "constitutionally core" under *Stern v. Marshall*, 564 U.S. 462 (2011) and its progeny.

Statutory authority. Finally, Judge Drain concluded that he had statutory power to confirm and enter the third-party releases. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40-43. He started from the proposition that the Second Circuit, in *Deutsche Bank A.G. v. Metromedia Fiber Network*,

Inc., (In re Metromedia Fiber Network, Inc.), 416 F. 3d 136, 141 (2d Cir. 2005), had indicated that non-consensual third-party releases of claims against non-debtors could be approved, albeit only in "appropriate, narrow circumstances." In re Purdue Pharma L.P., 2021 WL 4240974, at *40. He noted that most of the Circuits were of that view and rejected the reasoning of those courts of appeal that held otherwise. Indeed, he asserted that the view of those Circuits (the Fifth, Ninth, and Tenth Circuits) – which is that Section 524(e) of the Bankruptcy Code precluded the grant of any such release in the context of a settlement - "has been effectively refuted." *Id.* at 101. He analogized the enjoining of third-party claims against non-debtors to his undoubted power to impose a preliminary injunction against the temporary prosecution of third-party claims in order to facilitate the reorganization process. And he asked rhetorically why such a stay could not become permanent if it was crucial to a reorganization process involving massive numbers of overlapping estate and thirdparty claims. Id. at 101-02.

Having concluded that Section 524(e) was not a statutory impediment to a Bankruptcy Court's approval of third-party releases, the Bankruptcy Judge then addressed the question of exactly what provision or provisions in the Bankruptcy Code conferred the necessary authority over claims against non-debtors on him. *Id.* at 101-03. He found such authority in the "necessary or appropriate" power in *75 Section 105(a) of the Bankruptcy Code coupled with Section 1123(b)(6)'s grant of power to "include any other appropriate provision not inconsistent with the applicable provisions of this title" – what the Seventh Circuit referred to in *In re Airadigm Communications, Inc.*, 519 F. 3d 640, 657 (7th Cir. 2008) as a bankruptcy court's "residual authority." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43. He also cited Sections 1123(b)(5) and 1129 of the Bankruptcy Code.

Judge Drain carefully noted that the release in this case extended beyond so-called "derivative" claims – claims that the Debtors could bring against the Sacklers– which claims could assuredly be released by a bankruptcy court exercising *in rem* jurisdiction over the *res* of the estate. But he concluded – largely in reliance on *In re Quigley Co., Inc.*, 676 F.3d 45, 59-60 (2d Cir. 2012) – that he had statutory authority to authorize the release of non-derivative – direct or particularized – claims, because the third party claims to be released in this case were "premised as a legal matter on a meaningful overlap with the debtor's conduct." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43-47. Such a claim – one that "essentially dovetail[s] with the facts of the

claimants' third-party claims against the Debtors" – was, in Judge Drain's view, "sufficiently close to the claims against the debtor to be subject to settlement under the debtor's plan if enough other considerations support the settlement." *Id.* at 105.

As noted above, Judge Drain did insist that the Section 10.7 Shareholder Release be modified so that it covered only third-party claims in which "a Debtor's conduct, or a claim asserted against the Debtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the shareholder released party." *Id.* at 105. In other words, he insisted that there be substantial factual overlap between the released particularized claims and the derivative claims that no one disputes he had the power to release, such that the released non-derivative claims were "sufficiently close to the claims against the debtor."

Metromedia analysis. Having disposed of all constitutional, jurisdictional, and statutory challenges to his authority to enter the Section 10.7 Shareholder Release (as modified), Judge Drain turned finally to whether this was the "unique" case in which it would be was appropriate to impose them. *Id.* at 105-06. He concluded that it was.

In this regard, he reviewed the law in the various circuits on the subject, viewing with special interest the Third Circuit's conclusion that:

"To grant non-consensual releases a court must assess 'fairness, necessity to the reorganization' and make specific actual findings to support these conclusions." *In re Cont'l Airlines*, 203 F. 3d 203, 214 (3d Cir. 2001). Relevant consideration might include whether the non-consensual release is necessary to the success of the reorganization; whether the releasees have provided a critical financial contribution to the debtor's plan and whether that financial contribution is necessary to make the plan feasible; and whether the non-consenting creditors received reasonable compensation in exchange for the release, such that the release is fair." *In re Spansion, Inc.*, 426 B.R. 114, 144 (Bankr. D. Del 2010).

In re Purdue Pharma L.P., 2021 WL 4240974, at *46.

Judge Drain also cited with approval the Seventh Circuit's practice of engaging in a *76 fact-based inquiry into such matters as whether the release is "narrowly tailored, not blanket" (unlike the Section 10.7 Shareholder Release, which releases all types of conduct, including fraud and willful misconduct); whether the release is an essential component

of the plan; and whether it was achieved by the exchange of good and valuable consideration that will enable unsecured creditors to realize distributions (which is in fact going to happen in this case). *Id.* at 106.

Judge Drain also noted that the Fourth, Sixth and Eleventh Circuits apply a multi-factor test in deciding when it is appropriate to impose a non-consensual release of third-party claims. (*Id.* at 105-06).

Then, while recognizing that "this is not a matter of factors or prongs" (id. citing Metromedia, 416 F. 3d at 142), Judge Drain made a long list of findings about why this was the "rare" and "unique" case in which a nonconsensual third-party claims release was appropriate. Id. at 105-10. These include the following: (i) the Purdue bankruptcy was exceedingly complex; (ii) the Plan has overwhelming creditor support; (iii) without the Sackler payment the settlements would unravel; (iv) while not every Sackler would be making a specific payment toward the settlement, 44 the aggregate settlement payment hinged on each member of the family's being released; (v) the settlement amount was substantial; (vi) the release "is narrowly tailored." (vii) the settlement was fundamentally fair to the third parties; and (viii) for the reasons discussed at length supra, Background Section XII(B)(1), the cost and likelihood of success on the third party claims against the Sacklers – including both the merits and the impediments to collection of any judgment - was outweighed by the immediate and definite benefits of the settlement.

"Best interests" analysis. Section 1129 of the Bankruptcy Code requires that a plan of reorganization may be confirmed only if a litany of requirements is met. One such requirement is found in Subsection (a)(7) of Section 1129, which provides that, for any impaired creditor or class of creditors, if all members of the class do not approve the plan, each member of the class "will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *50.

Judge Drain applied this so-called "best interests" test to conclude that the holders of claims against non-debtor third parties would receive, on account of the Plan (and taking into account their claims against the Debtors as well as the third parties), materially more than they would receive in a *77 hypothetical chapter 7 liquidation. 46 *Id.* at 110-12.

State police powers. Judge Drain concluded that his ordering of the non-debtor releases did not violate state sovereignty or any state police power. *Id.* at 111-14. He concluded that actions exempted from the automatic stay by virtue of Section 362(b)(4) were nonetheless subject to court-ordered (*i.e.*, not automatic) injunctive relief, and that Congress' express power under the bankruptcy clause of the Constitution to enact uniform bankruptcy laws overrode any state regulatory or sovereignty argument.

The classification of the Canadians. Finally, Judge Drain addressed whether that the Canadian creditor's classification as Class 11(c) creditors, rather than as Class 4 and 5 creditors, was impermissible. Certain Canadian creditor groups objected to the confirmation of the Plan, arguing that they should be classified with the U.S. unsecured creditor groups in Classes 4 and 5 to participate in the opioid abatement trusts created under the Plan for those classes, rather than receiving their pro rata share of the cash payment to Class 11(c). But Judge Drain concluded that, because there were legitimate reasons for separately classifying the Canadian unsecured creditors from there domestic counterparts, the classification was perfectly permissible. First, the Canadian creditors operate under "different regulatory regimes ... with regard to opioids and abatement" than their domestic counterparts. In re Purdue Pharma L.P., 2021 WL 4240974, at *12. And second, "the allocation mediation conducted by Messrs. Feinberg and Phillips that resulted in the plan's division of the Debtors' assets ... involved only U.S.-based public claimants with their own regulatory interests and characteristics." *Id.* (emphasis added).

XIII. The Appeal

The U.S. Trustee, eight states, ⁴⁷ D.C., certain Canadian municipalities and First Nation groups, ⁴⁸ and five *pro se* individuals ⁴⁹ filed notices of appeal of Judge Drain's Confirmation Order in September 2021. (*See* Bankr. Dkt. No. 3724 (amended by Dkt. No. 3812), 3725, 3774 (amended by 3949), 3775 (amended by 3948), 3776 (amended by 3799), 3780 (amended by Dkt. No. 3839), 3784 (amended by Dkt. No. 3818), 3810, 3813, 3832, 3849, 3851, 3853, 3877, 3878). The U.S. Trustee also appealed the Advance Order (Bankr. Dkt. No. 3777) and the Disclosure Order (Dkt. No. 3776).

*78 Among those who did not appeal the Plan were the UCC, the ACH, MSGE, the PI Ad Hoc Group, and other creditors supporting the Plan.

ISSUES ON APPEAL AND CONCLUSIONS OF LAW

This Court's answers to the questions that are being decided on appeal are summarized as follows:

1. <u>Does the Bankruptcy Court have subject matter</u> jurisdiction to impose a release of non-debtor claims?

Yes. Under the law of this Circuit, as most recently set forth in *SPV OSUS Ltd. v. UBS*, 882 F.3d 333 (2d Cir. 2018), the Bankruptcy Court has broad "related to" jurisdiction over any civil proceedings that "might have any conceivable effect" on the estate. *Id.* 339-340. Because the civil proceedings asserted against the non-debtor Sackler family members *might have* a conceivable impact on the estate, the Bankruptcy Court has subject matter jurisdiction to approve the Section 10.7 Shareholder Release and release the claims against the non-debtor Shareholder Released Parties.

2. <u>Does the Bankruptcy Court have statutory authority to approve the non-debtor releases?</u>

No. The Bankruptcy Code does not authorize a bankruptcy court 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 Confirmation Order fails to identify any provision of the Bankruptcy Code that provides such authority. Contrary to the bankruptcy judge's conclusion, Sections 105(a) and 1123(a)(5) & (b) (6), whether read individually or together, do not provide a bankruptcy court with such authority; and there is no such thing as "equitable authority" or "residual authority" in a bankruptcy court untethered to some specific, substantive grant of authority in the Bankruptcy Code. Second Circuit law is not to the contrary; indeed, the Second Circuit has not yet taken a position on this question.

3. <u>Did the Bankruptcy Court fail to provide equal treatment between the Canadian Appellants and their domestic unsecured creditor counterparts?</u>

No. Under the Plan, the Canadian Appellants belong to a different class than their domestic, unsecured creditor "counterparts" – the non-federal governmental claimants and tribe claimants – but legitimate reasons are proffered for that

differentiation. The Code does not require that all creditor classes be treated the same – only that there be a reasonable basis for any differentiation between classes. *See Boston Post Rd. Ltd. P'ship v. FDIC (In re Boston Post Rd. Ltd. P'ship)*, 21 F.3d 477, 482-83 (2d Cir. 1994). Here, Judge Drain identified a reasonable basis for differentiating between the Canadian Appellants and the non-federal governmental claimants and tribe claimants. The Plan's classification of the Canadian Appellants thus does not violate the Bankruptcy Code.

It is not necessary to reach any of the other issues that were briefed. The issues identified above are dispositive of all the appeals that have been filed. ⁵⁰ Nor is it *79 necessary to reach either the various constitutional challenges to the Section 10.7 Shareholder Release (lack of due process, infringement on state police powers), or to decide whether, if there were no other legal impediment to approving the Section 10.7 Shareholder Release, it should be approved on the facts of this particular case.

STANDARD OF REVIEW

[8] [9] The Court has jurisdiction to hear [6] [7] bankruptcy appeals pursuant to 28 U.S.C. § 158(a). "Generally in bankruptcy appeals, the district court reviews the bankruptcy court's factual findings for clear error and its conclusions of law de novo." In re Charter Commc'ns, Inc., 691 F.3d 476, 482-83 (2d Cir. 2012) (citing Fed. R. Bankr. P. 8013). Conclusions of law reviewed de novo include "rulings as to the bankruptcy court's jurisdiction" and "interpretations of the Constitution." In re Motors Liquidation Co., 829 F.3d 135, 152, 158 (2d Cir. 2016). As to findings of fact, the "clear error standard is a deferential one." Id. at 158. A finding of fact is clearly erroneous only if this Court is "left with the definite and firm conviction that a mistake has been committed." In re Lehman Bros. 3 Holdings Inc., 855 F.3d 459, 469 (2d Cir. 2017).

[10] [11] The standard of review of findings of act is far less deferential if a bankruptcy court is presented with something it cannot adjudicate to final judgment as a constitutional matter unless the parties consent. *Stern v. Marshall*, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). In such a circumstance, a bankruptcy judge has authority only to "hear the proceeding and submit proposed findings of fact and conclusions of law to the district court for *de novo* review and entry of judgment." *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 34-36, 134 S.Ct. 2165, 189 L.Ed.2d 83 (2014).

In that case, the findings of fact are reviewed *de novo* as well. If a bankruptcy court issues a final order in the mistaken belief that it has constitutional authority to do so, the district court can treat a bankruptcy court's order as a report and recommendation, but it "must review the proceeding *de novo* and enter final judgment." *Id.* at 34, 134 S.Ct. 2165.

[12] In this case, the Bankruptcy Court concluded that it had constitutional authority under *Stern* to enter a final order granting the release, because the issue arose in the context of confirming a plan of reorganization – the most "core" of bankruptcy proceedings. *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40. Appellants urge that Judge Drain misreads *Stern* and argue that he lacked authority to give final approval to those releases, even though they were incorporated into a plan of reorganization.

I agree with Appellants.

[13] [14] [15] In 28 U.S.C. § 157(a), Congress divided bankruptcy proceedings into three types: (1) those that "arise under" title 11; (2) those that "arise in" a title 11 case; (3) and those that are "related to" a title 11 case. Cases that "arise under" or "arise in" a title 11 matter are known as are non-core. 28 U.S.C. § 157(b)(1)-(2)(C). Every proceeding pending before a bankruptcy court is either core or non-core. ⁵¹

***80** [16] [17] [18] The core vs. non-core distinction is critical when assessing a bankruptcy court's constitutional authority to enter a final judgment disposing of that proceeding.⁵² In particular, a bankruptcy court lacks the constitutional authority to enter a final judgment in a proceeding over which it has only "related to" subject matter jurisdiction unless all parties consent. Any doubt on that score was put to rest by the United States Supreme Court in Stern v. Marshall, 564 U.S. 462, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011). In that case, the Supreme Court held that a bankruptcy court lacked constitutional power to adjudicate and enter judgment on a counterclaim asserted by a debtor, Vickie Marshall (aka Anna Nicole Smith) in an adversary proceeding that a creditor (her stepson) had filed against her. The counterclaim (for tortious interference with an inter vivos gift from the debtor Marshall's late husband, who was also the creditor's father) did not arise under title 11, nor did it arise in a title 11 case. Even though the claim was asserted in the context of a bankruptcy proceeding, it existed prior to and was independent of debtor Marshall's bankruptcy case.

The Supreme Court ruled that Congress could not "withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at common law, or in equity, or in admiralty." *Murray's Lessee v. Hoboken Land & Improvement Co.*, 59 U.S. 272, 284, 18 How. 272, 15 L.Ed. 372 (1855). Because Marshall's counterclaim for tortious interference was just such a claim, it could only be adjudicated to final judgment by an Article III court; and Congress had no power to alter that simply because the counterclaim might have "some bearing on a bankruptcy case." *Stern*, 564 U.S. at 499, 131 S.Ct. 2594.

In this case, the learned Bankruptcy Judge improperly elided his authority to confirm a plan of reorganization (indubitably a core function of a bankruptcy court) with his authority to finally dispose of claims that were non-consensually extinguished pursuant to that plan over which - as he himself recognized - he has only "related to" jurisdiction over the third-party claims against the non-debtor Sacklers. In re Purdue Pharma L.P., 2021 WL 4240974, at *36-38. Stern itself illustrates that not every issue that is litigated under the umbrella of a core proceeding is, to use Judge Drain's phrase, "constitutionally core." The stepson-creditor's claim against Marshall's estate was properly litigated to judgment by the bankruptcy court in a claims allowance adversary proceeding - a core proceeding - but because the debtor's counterclaim was not a "core" claim, it could not be adjudicated to final judgment by the Bankruptcy Court, even though it would impact how much the creditor was ultimately owed.

[19] Judge Drain reasoned that the non-consensual third-party releases that he was approving were "constitutionally core" under *Stern* because plan confirmation is a "fundamentally central aspect of a Chapter 11 case's adjustment of the debtor/creditor relationship." *Id.* at *40. But nothing in *Stern* or any other case suggests that a party otherwise entitled to have a matter adjudicated by an Article III court forfeits that constitutional right if the matter is disposed of as part of a plan of reorganization in bankruptcy. Were it otherwise, then parties could manufacture a bankruptcy court's *Stern* authority simply by inserting the resolution of some otherwise non-core matter into a plan.

*81 The learned bankruptcy judge relied on the Third Circuit's recent decision in *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 139 (3d Cir. 2019), *cert. denied sub nom. ISL Loan Tr. v. Millennium Lab Holdings II, LLC*, — U.S. —, 140 S. Ct. 2805, 207 L.Ed.2d 142 (2020). In

Millennium, the court, like Judge Drain in this case, concluded that the "operative proceeding" for purposes of Stern analysis was the confirmation proceeding, not the underlying third-party claim against a non-debtor that was being released pursuant to the plan. In re Millennium Lab Holdings II, LLC, 591 B.R. 559, 574 (D. Del. 2018), aff'd sub nom. In re Millennium Lab Holdings II, LLC., 945 F.3d 126 (3d Cir. 2019). The Third Circuit read Stern to allow a bankruptcy court to confirm a plan containing such releases "because the existence of the releases and injunctions" are " 'integral to the restructuring of the debtor-creditor relationship.' "Millennium Lab Holdings II, LLC., 945 F.3d at 129 (quoting Stern, 564 U.S. at 497, 131 S.Ct. 2594).

[20] Perhaps they are, but that is beside the point. In *Stern*, the Supreme Court held that bankruptcy courts have the power to enter a final judgment only in proceedings that "stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process." Stern, 564 U.S. at 499, 131 S.Ct. 2594. It did not say that a bankruptcy court could finally dispose of non-core proceedings as long as they were "integral to the restructuring of the debtor-creditor relationship." The counterclaim in the lawsuit between debtor Marshall and her stepson-creditor was integral to the restructuring of their debtor-creditor relationship, but it was not a core proceeding, so the bankruptcy court could not finally adjudicate it. The correct constitutional question, and the question on which the Bankruptcy Court should have focused in this case, is whether the third-party claims released and enjoined by the Bankruptcy Court either stem from the bankruptcy itself or would necessarily be resolved in the claims allowance process – not whether the release and injunction are "integral to the restructuring of the debtorcreditor relationship."

[21] [22] The third-party claims at issue neither stem from Purdue's bankruptcy nor can they be resolved in the claims allowance process. Yet those claims are being finally disposed of pursuant to the Plan; they are being released and extinguished, without the claimants' consent and without any payment, and the claimants are being enjoined from prosecuting them. Debtors and their affiliated non-debtor parties cannot manufacture constitutional authority to resolve a non-core claim by the artifice of including a release of that claim in a plan of reorganization. As Bankruptcy Judge Bernstein made clear in *In re SunEdison, Inc.*, 576 B.R. 453, 461 (Bankr. S.D.N.Y. 2017), "In assessing a court's jurisdiction to enjoin a third party dispute under a plan, the question is not whether the court has jurisdiction over

the settlement that incorporates the third party release, but whether it has jurisdiction over the attempts to enjoin the creditors' unasserted claims against the third party." That proposition applies with equal force to a bankruptcy court's *Stern* authority.

[23] Appellees' argument that *Stern* only limits a bankruptcy court's authority to adjudicate claims - not its authority to enter judgments that terminate claims without adjudicating them on the merits - is also flawed. As the U.S. Trustee correctly points out, Stern's holding is to the contrary: "The Bankruptcy Court in this case exercised the judicial power of the United States by entering a final judgment on a common law tort claim, even *82 though the judges of such courts enjoy neither tenure during good behavior nor salary protection." Stern, 564 U.S. at 469, 131 S.Ct. 2594 (emphasis added). A bankruptcy court's order extinguishing a non-core claim and enjoining its prosecution without an adjudication on the merits "finally determines" that claim. It is equivalent to entering a judgment dismissing the claim. It bars the claim under principles of former adjudication. Therefore, Congress may not allow a bankruptcy court to enter such an order absent the parties' consent - and consent is lacking here. See Stern at 484, 131 S.Ct. 2594.

There really can be no dispute that the release of a claim "finally determines" that claim. It does so by extinguishing the claim, so that it cannot be adjudicated on the merits. A nonconsensual third-party release is essentially a final judgment against the claimant, in favor of the non-debtor, entered "without any hearing on the merits." In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 725 (Bankr. S.D.N.Y. 2019) (citing In re Digital Impact, 223 B.R. 1, 13 n. 6 (Bankr. N.D. Okla. 1998)) (noting that a third-party release has "the effect of a judgment – a judgment against the claimant and in favor of the non-debtor, accomplished without due process."). The fact that the releases are being ordered in the overall context of a plan confirmation that "settles" many disputed matters (against the Debtors, not against nondebtors) does not alter this. The Appellants in this case do not want to settle their claims against the non-debtors – at least, not on the terms set forth in the Plan. This "settlement" is nonconsensual – which means that, under *Stern*, a bankruptcy court cannot enter the order that finally disposes of their claims against those non-debtors.

Nor is there any doubt that the entry of an order releasing a claim has former adjudication effects, which is a key attribute of a final judgment. The Supreme Court has twice held that non-consensual third-party releases confirmed by final order are entitled to *res judicata* claim preclusion barring any subsequent action bringing a released claim: First in *Stoll v. Gottlieb*, 305 U.S. 165, 171, 59 S.Ct. 134, 83 L.Ed. 104 (1938), and again in *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137, 155, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009).⁵³

Because the non-consensual releases and injunction are the equivalent of a final judgment for *Stern* purposes, Judge Drain did not have the power to enter an order finally approving them. To the extent of his approval of the Section 10.7 Shareholder Releases, his opinion should have been tendered as proposed findings of fact and conclusions of law, both of which this court could review *de novo*. 11 U.S.C. § 157(c)(1). *Stern*, 564 U.S. at 475, 131 S.Ct. 2594. If approved by this Court, those releases would of course be incorporated into the Plan.

So the standard of review in this case is *de novo* as to both the Bankruptcy Court's factual findings and its conclusions of law.⁵⁴

*83 DISCUSSION

I. The Bankruptcy Court Has Subject Matter Jurisdiction Over Third-Party Claims Against Non-Debtors That Might Have Any Conceivable Effect on the Debtors' Estate.

[24] [25] A bankruptcy court is a creature of statute. *See Celotex Corp. v. Edwards*, 514 U.S. 300, 307, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995). Its subject matter jurisdiction is *in rem* and is limited to the *res* of the estate. *Central Virginia Community College v. Katz*, 546 U.S. 356, 362, 126 S.Ct. 990, 163 L.Ed.2d 945 (2006) ("Bankruptcy jurisdiction, at its core, is *in rem.*"). Its jurisdiction is limited to "civil proceedings arising under title 11, or arising in or related to cases under title 11." 28 U.S.C. § 1334(b).

[26] [27] [28] A proceeding "arises under" title 11 if the claims "invoke substantive rights created by" that title. See In re Housecraft Industries USA, Inc., 310 F.3d 64, 70 (2d Cir. 2002). A proceeding "arises in" a title 11 case if for example "Parties ..., by their conduct, submit themselves to the bankruptcy court's jurisdiction" by litigating proofs of claim without contesting personal jurisdiction. In re Millenium Seacarriers, Inc., 419 F.3d 83, 98 (2d Cir. 2005); see In re S.G. Phillips Constructors, Inc., 45 F.3d 702, 706 (2d Cir. 1995) ("a claim filed against the estate ... could arise

only in the context of bankruptcy") (emphasis in original) (quotation omitted). And a proceeding is "related to" a title 11 proceeding if its "outcome might have any conceivable effect on the bankrupt estate." In re Cuyahoga Equip. Corp., 980 F.2d 110, 114 (2d Cir.1992) Parmalat Capital Fin. Ltd. v. Bank of Am. Corp., 639 F.3d 572, 579 (2d Cir. 2011); SPV OSUS Ltd. v. UBS, 882 F.3d 333, 339-340 (2d Cir. 2018).

[29] [30] The release of most third-party claims against a non-debtor touches the outer limit of the Bankruptcy Court's jurisdiction. See In re Johns-Manville Corp., 517 F.3d 52, 55 (2d Cir. 2008) ("Manville III"), rev'd and remanded on other grounds sub nom. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009). But the Second Circuit defines that limit quite broadly. See SPV OSUS Ltd., 882 F.3d at 339-340. The standard is not that an action's outcome will certainly have, or even that it is likely to have, an effect on the res of the estate, as is the case in some other Circuits. It is, rather, whether it might have any conceivable impact on the estate. Id.

Bound to adhere to this broad standard, which has been consistently followed in this Circuit for almost three decades and was applied most recently in *SPV Osus*, I agree with the Debtors that the Bankruptcy Court had subject matter jurisdiction over the direct (non-derivative) third party claims against the Sacklers, under the "related to" prong of bankruptcy jurisdiction.

A. Governing Law

Decades ago, the Second Circuit concluded that the outer limit of a bankruptcy court's in rem jurisdiction was defined by whether the outcome of a proceeding asserting a particular claim "might have any conceivable effect" on the res of the estate. See In re Cuyahoga Equipment Corp., 980 F.2d at 114. In that case, a liquor distillery and its site of operation containing hazardous wastes was sold to a purchaser that subsequently went bankrupt; the bankruptcy court was asked to resolve not only the proceedings in bankruptcy but approve a settlement that released a creditor bank from claims related to separate environmental cleanup litigation (brought by the *84 creditor Environmental Protection Agency (the "EPA")). Id. at 111-112. The original owner of the liquor distillery site – a non-debtor third party and defendant in the environmental cleanup litigation – objected and appealed arguing, inter alia, that the court lacked jurisdiction to approve the settlement. The Second Circuit found that the court had related to jurisdiction because the bank's and the EPA's claims against the estate "bring into question the very

distribution of the estate's property." *Id.* at 114. "[Section] 1334(b) undoubtedly vested the district court with the power to approve the agreement between the parties at least to the extent it compromised the bankruptcy claims asserted by the bank and the government." *Id.* at 115.

In *Celotex Corp. v. Edwards*, 514 U.S. 300, 115 S.Ct. 1493, 131 L.Ed.2d 403 (1995), the United States Supreme Court decreed that "related to" jurisdiction was "a grant of some breadth" and that "jurisdiction of bankruptcy courts may extend ... broadly" in "reorganization under Chapter 11." *Id.* at 308, 115 S.Ct. 1493. And while some courts of appeal have circumscribed the scope of "related to" jurisdiction in their circuits, *see e.g.*, *In re W.R. Grace & Co.*, 900 F.3d 126 (3d Cir. 2018), the Second Circuit has never backed away from its broad reading of "related to" jurisdiction. *See, e.g., In re Ampal-American Israel Corporation*, 677 Fed.Appx. 5, 6 (2d Cir. 2017) (summary order).

The Circuit's most recent discussion of the subject can be found in SPV OSUS Ltd. v. UBS AG, 882 F.3d 333 (2d Cir. 2018). SPV Osus Ltd. ("SPV") had sued UBS AG ("UBS") (among others) in the New York State Supreme Court for aiding and abetting Bernie Madoff ("Madoff") and Bernard L. Madoff Investment Securities LLC ("BLMIS") in perpetrating their massive Ponzi scheme. *Id.* at 337-338. If UBS was indeed a joint tortfeasor with Madoff, it had a contingent claim for contribution against the Madoff estate. Id. at 340. However, it had not yet asserted such a claim (it was not yet ripe), and the unwaivable bar date for filing claims against the Madoff estate under the Securities Investor Protection Act ("SIPA") had already passed. Id. Moreover, there was no realistic possibility that there would be any money available at the end of the day to fund a claim for contribution. Id. SPV argued that these facts meant there was no possibility that the outcome of UBS' contribution case "might have any conceivable effect" on the res of the Madoff estate. Id. It is indeed hard to quarrel with that factual analysis.

But Judge Pooler, writing for a unanimous panel, concluded that UBS's contingent claim for joint tortfeasor contribution against the Madoff estate "might" have an effect on the Madoff estate if there were any "reasonable legal basis" for its assertion. *Id.* at 340-41 (quotation omitted). She explained that the broad jurisdictional standard reflects Congress' intent "'to grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate.'" *Id.* at 340 (quoting *Celotex*, 514 U.S. at 308, 115 S.Ct. 1493). While

recognizing that "'related to' jurisdiction is not 'limitless,' "Judge Pooler indicated that "it is fairly capacious." *Id.* And she said, "'An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.' "*Id.* (quoting *Celotex*, 514 U.S. at 308, n. 6, 115 S.Ct. 1493).

The fact that UBS and the debtor (Madoff) were alleged to be joint tortfeasors – who, as a matter of state law, have a right *85 of contribution against one another – provided a "reasonable legal basis" why UBS might someday be able to assert its contingent claim. And while Judge Pooler recognized that "... a payout by the estate to defendants may be improbable, it is not impossible." *Id.* at 342. Since "any claim by defendants potentially alters that distribution of assets among the estates' creditors," *id.*, that was all it took to make the contingent claim "conceivably related" to the Madoff bankruptcy.

Finally – and of particular importance for the case at bar – Judge Pooler found that the "high degree of interconnectedness between this action and the Madoff bankruptcies" supported a finding of "related to" jurisdiction. *Id.* She explained that, "SPV can only proceed on [its claims against UBS] if it establishes that the Madoff fraud occurred" and "it is difficult to imagine a scenario wherein SPV would not also sue Madoff and BLMIS, given that SPV alleges that UBS aided and abetted in their fraud." *Id.*

[31] So in this Circuit, it is well settled that the only question a court need ask is whether "the action's outcome *might have* any conceivable effect on the bankrupt estate." *Id.* (emphasis added). If the answer to that question is yes, then related to jurisdiction exists – no matter how implausible it is that the action's outcome actually will have an effect on the estate.

B. Application of the Law to the Facts

[32] Under the broad standard set forth in *SPV Osus*, I find that the Bankruptcy Court had "related to" subject matter jurisdiction to approve the release of direct, non-derivative third-party claims against the Sacklers. There is absolutely no question that the answer to the question of whether the third-party claims *might have* any conceivable impact on the res of the debtors' estate is yes. Moreover, the intertwining of direct and derivative claims against certain members of the Sackler family, as well as the congruence between the only claim that anyone has identified against the other Sacklers

and Purdue's own claim for fraudulent conveyance, justifies the assertion of "related to" jurisdiction under *SPV Osus*'s "interconnectedness" test.

First, the non-derivative third-party claims that are being or might be asserted against the Sacklers are, as in *In re Cuyahoga Equipment Corp.*, the type of claims that "bring into question the very distribution of the estate's property." 980 F.2d at 114. As the Debtors pointed out in oral argument, and as Judge Drain recognized in his opinion, pursuit of the third-party claims threatens to "unravel[] the plan's intricate settlements" and "recoveries on ... judgments" against the Sacklers would have a "catastrophic effect" on all parties' possible recovery under the Plan. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *33; (Oral Arg. Tr., Nov. 30, 2021, at 124:14-16 ("Continued litigation against the Sacklers destroys all of the interlocking intercreditor settlements enshrined in the plan.")).

Second, as in SPV Osus, the claims raised against the Sacklers might have a conceivable impact on the estate, in that they threaten to alter "the liabilities of the estate" and "change" "the amount available for distribution to other creditors." SPV Osus, 882 F.3d at 341. This "is sufficient to find that litigation among non-debtors is related to the bankruptcy proceeding." Id

Here, the non-derivative litigation against the Sacklers *might* alter the liabilities and change the amount available for distribution. If, for example, the Appellants were successful in their related claims against the Sacklers, the findings *86 could alter, or even determine, Purdue's own liability on similar claims, as well as the amount owed to Appellants as creditors. Further, as the Debtors explained at oral argument, there also is the threat that the Appellants' claims could affect "the debtors' ability to pursue the estate's own closely related, indeed, fundamentally overlapping claims against the Sacklers"; this is so because, if the related third-party claims were litigated poorly, the debtor's estate might be less likely to recover on its own claims against the Sacklers, which are worth billions. (*See* Oral Arg. Tr., Nov. 30, 2021, at 123:17-124:13).

Judge Drain pointed out the conceivable effect that the potential alteration of liabilities and ultimate amounts owed creditors and the estate would have on the *res* in his opinion. *See In re Purdue Pharma L.P.*, 2021 WL 4240974, at *37. I agree that these potential effects support a finding of "related to" jurisdiction.

Third, as in *SPV Osus*, all the claims in this case have a high degree of interconnectedness with the lawsuits against the debtors and against the Sacklers – especially those members of the family who can be sued derivatively as well as directly.

As the *SPV Osus* Court explained, "'The existence of strong interconnections between the third-party action and the bankruptcy has been cited frequently by courts in concluding that the third-party litigation is related to the bankruptcy proceeding." "*SPV OSUS*, 882 F.3d at 342 (quoting *In re WorldCom, Inc. Sec. Litig.*, 293 B.R. 308, 321 (S.D.N.Y. 2003)). Here, the Section 10.7 Shareholder Release only extends to those claims where the "debtor's conduct or the claims asserted against it [are] a legal cause or a legally relevant factor." (Confr. Hr'g Tr., Sept. 1, 2021, at 134:18-135:2); *see In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45; Plan, at § 10.7(b)). This limitation alone supports a conclusion that any claim that could fall within the scope of the release would necessarily have a high degree of interconnectedness with the debtor's conduct.

Looking at the claims of the Appellants themselves, the interconnectedness of the claims against the Sacklers with those against the Debtors is patent. (See, e.g., Dkt. No. 103-7, at A-1553; Dkt. No. 95-1, at A0008; Dkt. No. 91-7, at App.2598; Dkt. No. 91-8, at App.2661; Dkt. No. 91-9, at App.3153). In fact, the direct and derivative claims against the "insider" or "managerial" Sacklers are essentially congruent. The Appellants have asserted claims in multiple instances against both Purdue and the Sacklers, and in every case they rely on detailed and virtually identical sets of facts to make the claims. Because various state statutes authorize the assertion of direct claims against certain managerial personnel of a corporation who can be held independently liable for the same conduct that subjects the corporation to liability (and them to liability to the corporation for faithless service in their corporate roles), a determination in one of the State Appellants' cases would likely have preclusive impact on a case alleging derivative liability against the same people - a case over which the Bankruptcy Court has undoubted jurisdiction. As the Debtor pointed out at oral argument, there is an obvious inconsistency in bringing "lawsuits against the Sackler[s] alleging that they controlled Purdue, and that Purdue did terrible things, and 500,000 people's lives were maybe snuffed out by Purdue's conduct" yet arguing that those suits "will [not] affect the debtors in any conceivable way." (See Oral Arg. Tr., Nov. 30, 2021, at 123:12-17). Some things have not changed since this court decided *Dunaway v*.

Purdue Pharma. L.P., 619 B.R. 38 (S.D.N.Y. 2020); one that has not is this: "Appellants would rely on the same facts to establish *87 the liability of both parties" and there would be "no way for the Appellants to pursue the allegations against Dr. Sackler without implicating Purdue, and vice versa." Id. at 51. The acts of the Sacklers that could form the basis of any released claim "are deeply connected with, if not entirely identical to, Purdue's alleged misconduct." See id.

In so holding, I acknowledge that in In re Johns-Manville Corp., 517 F.3d 52 (2d Cir. 2008) ("Manville III"), rev'd and remanded on other grounds sub nom. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 129 S.Ct. 2195, 174 L.Ed.2d 99 (2009) and In re Johns-Manville Corporation v. Chubb Insurance, 600 F. 3d 135 (2d Cir. 2010) ("Manville IV"), the Second Circuit said that the existence of shared facts between claims against the debtor and claims against the non-debtor arising out of an independent legal duty that was owed by the nondebtor to a third party was not sufficient to confer "related to" subject matter jurisdiction over the claims against the nondebtors. Manville III, 517 F.3d at 64-65. As a result, the Court of Appeals held that the bankruptcy court lacked jurisdiction to enjoin the prosecution of claims asserted by third parties against Travelers, Manville's erstwhile insurer, that arose out of Travelers' alleged failure to alert those third parties to the harmful properties of asbestos, about which Travelers had allegedly learned during its long relationship with Manville. Id. at 65. However, while there was a substantial factual overlap between defective product claims against Manville and the failure to disclose claims asserted against its insurer Travelers that were discussed in Manville III, there was absolutely no basis for asserting that there could be any impact on the res of Manville's bankruptcy estate if the third party claims were not enjoined. For that reason, Manville III/IV is not inconsistent with SPV OSUS.

The fact that the release extends to members of the Sackler family who played no role in running the affairs of the company does not alter the analysis. At the present time, the court is not aware of any lawsuits that have been brought against any of those individuals; and despite months of my asking, no one can identify any claim against them that would be released by the Section 10.7 Shareholder Release, other than as the recipients of money taken out of Purdue and up-streamed to the family trusts. But any claims relating to those transfers rightfully belong to the Debtors, whose claims against the world either "arise under" or "arise in" the bankruptcy. And those claims are not implicated by the Section 10.7 Shareholder Release.

<u>Fourth</u>, it is more than conceivable that Purdue's litigation of the question of its indemnification, contribution, or insurance obligations to the director/officer/manager Sacklers could burden the assets of the estate.

Appellants – most particularly the State and Canadian Appellants – insist that their claims lie beyond the "related to" jurisdiction of the Bankruptcy Court in part because their laws bar indemnification, contribution, or insurance coverage for actions like those of the Sacklers (*see* Dkt. Nos. 224, 228-231), and so the claims cannot be extinguished by that court. Without viable claims for indemnification, contribution, or insurance claims, the Appellants argue that their claims against the Sacklers will not have any conceivable effect on the Debtors' estate, thereby depriving the Bankruptcy Court of subject matter jurisdiction.

I begin by noting that this is precisely the type of reasoning that Judge Pooler rejected in *SPV Osus* – a case, I submit, in which the actual possibility that a contingent *88 contribution claim would have any impact on the *res* of the Madoff estate was far less likely than it is in this case. The issue is not whether, at the end of the day, the Sacklers would lose on their contingent claims; it is whether they have a reasonable legal basis for asserting them. (*See* Dkt. Nos. 154, 156).

[33] And the Sacklers do have a reasonable legal basis to assert those claims. The Sacklers named in the State Appellants' suits served as officers, directors or managers of Purdue. As a result, they have claims against Purdue for indemnification and contribution, as well as a call on any D&O insurance proceeds that cover Purdue's officer and directors. As this court noted almost two years ago in Dunaway, Purdue's current and former directors and officers of the company are covered by various Limited Partnership Agreements ("LPA"), which provide that Purdue shall indemnify these directors and officers "so long as the Indemnitee shall be subject to any possible Proceeding by reason of the fact that the Indemnitee is or was ... a director, officer or Agent of [the Purdue entities]." (JX-1773; see also JX-1806; JX-1049). The various state unfair trade practices laws that have been cited to this court all subject the Sacklers to the potential for liability because of their status as officers, directors or managers of the corporation – even though that liability is direct, not derivative. Moreover, the LPAs are governed by Delaware law, which allows for indemnification (see 6 Del. C. § 17-108; 8 Del. C. § 145), and the states

as a general matter look to the state of incorporation for the availability of indemnity. (See, e.g., Dkt. No. 230, at 3, 8-9, 13, 17). Similarly, the Purdue insurance policies that cover the Sackler former directors could be depleted, inter alia, if a Sackler former director prevailed in litigation or a plaintiff prevailed in litigation on a non-fraud claim. (See Dkt. No. 156, at 15). 55 Under various state laws, the Sacklers parties can also seek an advance against defense costs; even if those costs are ultimately recouped, those defense funds will, for at least some time, leave the estate. See CT Gen Stat § 33-776; 8 Del. C. § 145. The law governing insurance coverage is generally the law governing the policy - not the law of the objecting state. Only one state has an exception to that - California, whose law specifically prohibits indemnity or insurance coverage for losses resulting from a violation of its false advertising law or unfair competition law, and under which law an insurer has no duty to defend or advance costs. (Dkt. No. 95, at 3-4); see Cal. Ins. Code § 533.5; Adir International, LLC v. Starr Indemnity and Liability Co., 994 F.3d 1032, 1045 (9th Cir. 2021).

And while each objecting state asserts that its laws would bar one or more of indemnification, contribution or insurance in certain instances, no state's law bars all three – not even California's. (See Dkt. Nos. 228-231; see also Dkt. No. 224).

Recognizing this, the states argue that there can be no indemnification, contribution, or insurance on these facts, including on public policy grounds, because the Sacklers acted in bad faith. (See e.g., Dkt. No. 230, at 2). However, the question of bad faith in this case is hotly disputed. There is no doubt that the Shareholder Released Parties' right to indemnification, *89 contribution, and/or insurance will be vigorously litigated, as Judge Drain rightly pointed out below. See In re Purdue Pharma L.P., 2021 WL 4240974, at *38. That litigation will cost money. And so it very well might have an impact on the estate; in fact, it likely will have such an impact.

Given the breadth of the Second Circuit law under *SPV Osus*, I must and I do find that the claims asserted against the Shareholder Released Parties *might have* some conceivable effect on the estate of a debtor, for each of the foregoing reasons, and thus fall within the "related to" jurisdiction of the Bankruptcy Court.

But that only gets us to the next question. And it is the next question that is, in my view, dispositive.

II. The Bankruptcy Court Does Not Have Statutory Power to Release Particularized Third-Party Claims Against Non-Debtors.

[34] Appellants argue that the Bankruptcy Court has no statutory authority to approve a release of third-party claims against non-debtors.

One would think that this had been long ago settled.

It has not been.

There is a long-standing conflict among the Circuits that have ruled on the question, which gives rise to the anomaly that whether a bankruptcy court can bar third parties from asserting non-derivative claim against a non-debtor—a matter that surely ought to be uniform throughout the country—is entirely a function of where the debtor files for bankruptcy.

And while the Second Circuit long ago identified as questionable a court's statutory authority to do this outside of asbestos cases, *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005), it has not yet been required to identify any source for such authority.

Lacking definitive guidance from our own Court of Appeals, Judge Drain consulted the law in every Circuit. He concluded that he was statutorily authorized to approve the Section 10.7 Shareholder Release because it is "subject to 11 U.S.C. 1129(a)(1), 1123(a)(5) & (b)(6), 105, and 524(e)." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43. "In other words," he stated, "those releases flow from a federal statutory scheme." *Id*.

I appreciate that this Court has, on a prior occasion, said exactly the same thing, using exactly the same language – albeit in the context of affirming a plan that contained an easily distinguishable injunction that barred third parties (one in particular) from bringing one specific type of claim against non-debtors (his former partners) in order to protect the integrity of bankruptcy court orders. *In re Kirwan Offices S.à.R.L.*, 592 B.R. 489, 511 (S.D.N.Y. 2018), *aff'd sub nom. In re Kirwan Offices S.a.R.L.*, 792 F. App'x 99 (2d Cir. 2019). But in *Kirwan*, this Court did not analyze whether there was a statutory (as opposed to a jurisdictional or constitutional) basis for the injunction that was at issue in that case. Indeed, no statutory argument was made. ⁵⁶

In this case, however, Appellants – most particularly, the U.S. Trustee, with the United States Attorney for this District appearing as *amicus* – have mounted a *90 full-throated attack on a court's statutory authority to release third-party claims against non-debtors in connection with someone else's bankruptcy.

With the benefit of full briefing and extensive argument from experienced counsel, it is possible to decide whether a court adjudicating a bankruptcy case has the power to release third-party claims against non-debtors. Moreover, it is necessary to reach a conclusion on this subject before delving into constitutional issues that need not be reached if Appellants are correct.

I conclude that the sections of the Code on which the learned Bankruptcy Judge explicitly relied, whether read separately or together, do not confer on any court the power to approve the release of non-derivative third-party claims against non-debtors, including specifically the Section 10.7 Shareholder Release that is under attack on this appeal.

As no party has pointed to any other section of the Bankruptcy Code that confers such authority, I am constrained to conclude that such approval is not authorized by statute.

A Caveat and Some Definitions: I begin this discussion with a caveat. The topic under discussion is a bankruptcy court's power to release, on a non-consensual basis, direct/particularized claims asserted by third parties against non-debtors pursuant to the Section 10.7 Shareholder Release. This speaks to a very narrow range of claims that might be asserted against the Sacklers.

[35] [36] For these purposes, by derivative claims, I mean claims that would render the Sacklers liable because of Purdue's actions (which conduct may or may not have been committed because of the Sacklers). "Derivative" claims are those seek to recover from the estate indirectly "on the basis of [the debtor's] conduct," as opposed to the non-debtor's own conduct. Manville III, 517 F.3d at 62 (quoting MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89 (2d Cir. 1988)). Derivative claims in every sense relate to the adjustment of the debtor-creditor relationship, because they are claims that relate to injury to the corporation itself. If the creditor's claim is one that a bankruptcy trustee could bring on behalf of the estate, then it is derivative. Madoff, 40 F.3d at 90.

[37] By direct claims, I mean claims that are not derivative of Purdue's liability, but are based on the Sacklers' own, individual liability, predicated on their own alleged misconduct and the breach of duties owed to claimants other than Purdue. "Direct" claims are based upon a "particularized" injury to a third party that can be directly traced to a non-debtor's conduct. *Id*.

The release of claims against the Sacklers that are derivative of the estate's claims them is effected by Section 10.6(b) of the Plan, which is not attacked as being beyond the power of the Bankruptcy Court.

[38] The Section 10.7 Shareholder Release under attack is different. It releases all members of the Sackler families, as well as a variety of trusts, partnerships and corporations associated with the family and the people who run and advise those entities, ⁵⁷ from liability for claims that *91 have been brought against them personally by third parties - claims that are not derivative, but as to which Purdue's conduct is a legally relevant factor. Example: nearly all of the State Appellants have a law under which individuals who serve in certain capacities in a corporation are individually and personally liable for their personal participation in certain unfair trade practices. As Judge Drain recognized (see In re Purdue Pharma L.P., 2021 WL 4240974, at *44), the liability imposed by these statutes is not derivative; the 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. Liability under those laws is limited to persons who occupied the roles of officer, manager or director of a corporation - which means that there is considerable factual overlap, perhaps even complete congruence, between those claims and the derivative claims against the same individuals that Judge Drain had undoubted authority to release and enjoin. But it is undisputed that these laws impose liability, and even penalties, on such persons independent of any corporate liability (or lack of same), and independent of any claim the corporation could assert against them for faithless service as a result of those same acts.⁵⁸

The discussion that follows, then, applies only to direct (non-derivative) claims – sometimes referred to as "particularized" claims – that arise out of the Sacklers' own conduct (*In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45), and that either have been or could be asserted against the non-debtor members of the Sackler family and their affiliates

(the Shareholder Released Parties) by parties other than the Debtors' estate.

The Text of the Bankruptcy Code

[39] As one always should when assessing statutory authority, we turn first to the text of the statute.

[40] All parties agree that one and only one section of the Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties. That section is 11 U.S.C. § 524(g), which was passed by Congress in 1994. It provides for such an injunction solely and exclusively in cases involving injuries arising from the manufacture and sale of asbestos. And it sets out a host of conditions that must be satisfied before any such injunction can be entered, including all of the following:

- (i) the injunction is to be implemented in connection with a trust the is to be funded in whole or in party by the securities of the debtor and that the debtor will make future payments, including dividends, to that trust 524(g) (2)(B)(i)(I);
- (ii) the extent of such alleged liability of a third party arises by reason of one of four enumerated relationships between the debtor and third party (524(g)(4)(A)(ii));
- (iii) as part of the proceedings leading to issuance of such injunction, the court appoints a legal representative for the purpose of protecting the rights of persons that might *92 subsequently assert demands of such kind (524(g) (4)(B)(i)); and
- (iv) the court determines the injunction is fair and equitable to persons that might subsequently assert such demands, and, in light of the benefits provided to such trust on behalf of such third parties. § 524(g)(4)(B)(ii)).

Section 524(g) injunctions barring third party claims against non-debtors cannot be entered in favor of just any non-debtor. They are limited to enjoin actions against a specific set of non-debtors: those who have a particular relationship to the debtor, including owners, managers, officers, directors, employees, insurers, and financiers. 11 U.S.C. § 524(g)(4)(A).

The language of the statute plainly indicates that Congress believed that Section 524(g) created an exception to what

would otherwise be the applicable rule of law. Subsection 524(g)(4)(A)(ii) says: "Notwithstanding the provisions of section 524(e), such an injunction may bar any action directed against a third party who is identifiable from the terms of such injunction (by name or as part of an identifiable group) and is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor." 11 U.S.C. § 524(g) (4)(A)(ii). Section 524(e) provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). The word "notwithstanding," suggests that the type of injunction Congress was authorizing in § 524(g) would be barred by § 524(e) in the absence of the statute.

A. Legislative History of the Statute

Section 524(g) was passed after the United States Court of Appeals for the Second Circuit had affirmed the entry of an unprecedented injunction barring claims against certain non-debtors in connection with the bankruptcy of the nation's leading manufacturer of asbestos, the Johns Manville Corporation. MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.), 837 F.2d 89, 91 (2d Cir. 1988) ("Manville I"). The permanent injunction in that case extended to actions against Manville's insurers, all of whom had dedicated the entire proceeds of their policies – proceeds on which parties other than Manville were additional insureds and had a call - to a settlement fund into which the claims of asbestos victims would be channeled, valued, and resolved. The Second Circuit concluded that the bankruptcy court could permanently enjoin and channel lawsuits against a debtor's insurer relating to those insurance policies because those policies were "property of the debtor's estate." Id. at 90. The Court of Appeals did not cite to a single section of the Bankruptcy Code as authorizing entry of the injunction.

Despite the Second Circuit's affirmance of the *Manville I* injunction, questions continued to be raised about its legality. Congress passed Sections 524(g) and (h) of the Bankruptcy Code to remove any doubt that those injunctions were authorized. *See* H.R. Rep. 103-835 at *41 (noting that Subsection (g) was added to Section 524 "in order to strengthen the Manville and UNR trust/injunction mechanisms and to offer similar certitude to other asbestos trust/injunction mechanisms that meet the same kind of high standard with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases").

That Section 524(g) applies only to asbestos cases is clear. The statute explicitly states than the trust that "is to assume the liabilities of a debtor" be set up in connection *93 with "actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestoscontaining products" (11 U.S.C. § 524(g)(B)(i)(I)). If that were not clear enough, Congress passed another section to provide that injunctions that had previously been entered in asbestos cases - not in any other kind of case would automatically be deemed statutorily compliant, even if those injunctions did not have all the features required by § 524(g). See, 11 U.S.C. § 524(h) ("Application to Existing Injunctions"). The limitation of § 524(h) to asbestos injunctions is important because, prior to the statute's passage, injunctions releasing third party claims against non-debtors had been entered by a few courts in cases involving other industries. See e.g., In re Drexel Burnham Lambert Grp., Inc., 960 F. 2d 285 (2d Cir. 1992) (securities); In re A.H. Robins Co., Inc., 880 F.2d 694 (4th Cir. 1989) (medical devices). The revisions to the Bankruptcy Code neither extend to those injunctions nor deem them to be statutorily compliant.

At the same Congress passed Sections 524(g) and (h), it passed Public Law 111, which provided a rule of construction for Section 524(g). It states that nothing in the 1994 amendments to the Bankruptcy Code, including 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." Pub. L. 103–394 § 111(b) (uncodified). Congress made this statement because the parties in non-asbestos bankruptcy cases took the position that Sections 524(g) and (h) were unnecessary, in that bankruptcy courts already authorized the entry of such injunctions and corresponding approval of non-debtor releases - viz, *Robins* and *Drexel*. But the passage of Public Law 111 did not mean that Congress agreed with that position. As the House Committee on the Judiciary noted in the legislative history of these new provisions:

Section 111(b) ... make[s] clear that the special rule being devised for the asbestos claim trust/injunction mechanism is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan [of] reorganization. Indeed, [asbestos suppliers] Johns–Manville and UNR firmly believe that the court in their cases had full authority to approve the trust/injunction mechanism. And other debtors in other industries are reportedly beginning to experiment with similar mechanisms. The Committee expresses no opinion as to how much authority a bankruptcy court may generally

have under its traditional equitable powers to issue an enforceable injunction of this kind.

Vol. E., *Collier on Bankruptcy*, at App. Pt. 9–78 (reprinting legislative history pertaining to the 1994 Code amendments) (emphasis added). P.L. 111 was not incorporated into the Bankruptcy Code.

Congress' used of the word "may" indicates that a bankruptcy court's authority to enter such an injunction was at best uncertain. And in light of the last sentence – in which the Committee made it clear that Congress expressed no opinion on that subject – one cannot read this tidbit of legislative history as indicating that Congress had concluded that a bankruptcy court already had such authority under its "traditional equitable powers."

During the course of this appeal, it has been suggested that P.L. 111 expresses Congress' intent to pass a limited law and then allow the courts to work out the contours of whether and how to extend § 524(g)-style authority outside the asbestos context.⁵⁹ The very next sentence from *94 that statute's legislative history reveals that nothing could be further from the truth:

The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved. How the new statutory mechanism works *in the asbestos area* may help the Committee judge whether the concept should be extended into other areas.

Id. (Emphasis added)

Plainly, Congress made a decision to limit the scope of the experimenting that was "reportedly" to be happening (and that was in fact happening) in other industries. And it left to itself, not the courts, the task of determining whether and how to extend a rule permitting non-debtor releases "notwithstanding the provisions of section 524(e)" into other areas.

Since 1994, Congress has been deafeningly silent on this subject.

B. Survey of the Relevant Case Law

1. Supreme Court Law

The United States Supreme Court has never specifically considered whether the non-consensual release of non-derivative claims asserted by third parties against non-debtors can be approved in the context of a debtor's bankruptcy. Indeed, on *certiorari* to the Second Circuit from one of its orders in the ongoing *Manville* saga, the High Court announced that its opinion did "not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's wrongdoing." *Travelers Indem. Co. v. Bailey*, 557 U.S. at 155, 129 S.Ct. 2195.

The Court has, however, spoken on several occasions about issues that are germane to the consideration of that question.

For one thing, the Court has indicated that the Bankruptcy Code was intended to be "comprehensive." *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645, 132 S.Ct. 2065, 182 L.Ed.2d 967 (2012) ("Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions") (quoting *Varity Corp. v. Howe*, 516 U.S. 489, 519, 116 S.Ct. 1065, 134 L.Ed.2d 130 (1996) (Thomas, J., dissenting)).

For another, it has held that the "traditional equitable power" of a bankruptcy court "can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988).

And in two recent cases, the Supreme Court has held, albeit in contexts different from the one at bar, that a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code – not even in "rare" cases, and not even when those orders would help facilitate a particular reorganization.

For example, in *Law v. Siegel*, 571 U.S. 415, 134 S.Ct. 1188, 188 L.Ed.2d 146 (2014), the Supreme Court unanimously held the bankruptcy court does not have "a general, equitable power" to order that a debtor's statutorily exempt assets be made available to cover attorney's fees incurred by an estate's trustee in the course of the chapter 7 bankruptcy case. Section 522 of the Bankruptcy Code, by reference to applicable state law, entitled the debtor in *95 that case to exempt equity in his home from the bankruptcy estate. *See* 11 U.S.C. § 522(b) (3)(A). A dispute arose between the debtor and the trustee of the estate, causing the trustee to incur substantial legal fees, purportedly as a result of the debtor's "abusive litigation

practices." *Law v. Siegel*, 571 U.S. at 415-16, 134 S.Ct. 1188. Seeking to recoup the cost of resolving the dispute with the debtor, the trustee asked the bankruptcy court to order that the otherwise exempt assets be made available to cover his attorney's fees. He argued that such an order was authorized by the "inherent power" of the Bankruptcy Court and by Section 105(a) of the Bankruptcy Code, which provides:

The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

[41] The High Court disagreed, stating flatly, "A bankruptcy court may not exercise its authority to 'carry out' the provisions of the Code" by taking an action inconsistent with its other provisions. Law v. Siegel, 571 U.S. at 425, 134 S.Ct. 1188. It announced that there is "no authority for bankruptcy courts to deny an exemption on a ground not specified in the Code," because the Bankruptcy Code was intended to be a comprehensive statement of the rights and procedures applicable in bankruptcy. Id. at 416, 134 S.Ct. 1188. The Code explicitly exempts certain debtor assets from the bankruptcy estate and provides a finite number of exceptions and limitations to those asset exemptions. See 11 U.S.C. § 522. To the Supreme Court, "comprehensive" means precisely that: "The Code's meticulous – not to say mind-numbingly detailed - enumeration of exemptions and exceptions to those exemptions confirms that courts are not authorized to create additional exceptions." Law v. Siegel, 571 U.S. at 424, 134 S.Ct. 1188.

[42] [43] More recently, in *Czyzewski v. Jevic Holding Corp.*, — U.S. —, 137 S. Ct. 973, 197 L.Ed.2d 398 (2017), the Court held that the protections explicitly afforded by the Bankruptcy Code could not be overridden in a "rare" case, even if doing so would carry out certain bankruptcy objectives. In chapter 11 bankruptcies, a plan that does not follow normal priority rules cannot be confirmed over the objection of an impaired class of creditors. 11 U.S.C § 1129(b). Notwithstanding that, the bankruptcy court in *Jevic* approved the structured dismissal⁶⁰ of a chapter 11 case in which unsecured creditors were prioritized over non-consenting judgment creditors — a violation of ordinary

priority rules. The bankruptcy court and the proponents of the structured dismissal argued that the Bankruptcy Code did not specifically state whether normal priority rules had to be followed in chapter 11 (as opposed to chapter 7) cases - that is, the statute was "silent" on the subject - so the court could exercise such authority in "rare" cases in which there were "sufficient reasons" to disregard priority. But the Supreme Court disagreed that any such power existed. It observed that the priority system applicable to those distributions had long been considered fundamental to the Bankruptcy *96 Code's purposes and held that the "importance of the priority system leads us to expect more than simply statutory silence if, and when, Congress were to intend a major departure." Jevic Holding Corp., 137 S. Ct. at 984. To the argument that a bankruptcy court could disregard priority if there were "sufficient reasons" to do so, Justice Breyer aptly noted: "It is difficult to give precise content to the concept 'sufficient reasons.' That fact threatens to turn a 'rare case' exception into a more general rule." Id. at 986.

It is with these holdings in mind that I examine the law in the various Circuits on the subject of non-consensual release of third-party claims against non-debtors.

I begin, of course, with our own.

2. Second Circuit Law

Manville I: The relevant law in the Second Circuit begins with Manville I, which has already been discussed. Manville's I's injunction was subsequently codified in §§ 524(g) and (h)⁶¹ – which, as noted above, are plainly in the Bankruptcy Code, and are limited to the asbestos context, and have never been extended by Congress to other areas of endeavor. It is, moreover, significant that the injunction authorized by the Second Circuit in Manville I extended only to claims against parties (insurance companies) holding property that was indisputably part of the res of the debtor's estate (policies covering Manville for the manufacture and sale of asbestos). As will be seen when we get to Manville III/IV, when the non-debtor was seeking a release in exchange for contributing property to the debtor's estate – as opposed to surrendering property that already was part of the debtor's estate - the result, even in a statutorily authorized asbestos case, was different.

<u>Drexel:</u> The debtor in *In re Drexel Burnham Lambert Grp.*, Inc., 960 F.2d 285 (2d Cir. 1992) was the investment

bank Drexel Burnham Lambert Group ("DBL"), which filed for bankruptcy in 1990. DBL's principal creditor was the Securities and Exchange Commission, which was owed \$150 million pursuant to a prior settlement. But over 15,000 creditors filed proof of claims against the estate, alleging fraud in connection with four different types of securities transactions.

Judge Milton Pollack of this district withdrew all of these securities claims from the bankruptcy court pursuant to 28 U.S.C. § 157(d) in order to facilitate their settlement. The parties negotiated a settlement that had as its key feature the certification of all the securities claimants into a single, mandatory, non-opt-out class (Rule 23(b)(1)(B)), which was itself divided into two subclasses: A and B. The members of Subclass B – comprised of securities fraud class action plaintiffs – were, as part of the settlement, enjoined from bringing any future actions against the former officers and directors of DBL; while not themselves debtors, those individuals had contributed to DBL's estate.

The district court certified the classes and approved the settlement over the objections of 8 of the 850 proposed class members. Three of the objectors filed appeals, contending in relevant part that the district court had erred by approving the settlement with it the mandatory injunction against the pursuit of third-party claims by non-consenting plaintiffs.

The Second Circuit affirmed the settlement of the securities fraud cases. It noted *97 in passing that, "In bankruptcy cases, a court may enjoin a creditor from suing a third party, provided this injunction plays an important part in the debtor's reorganization plan." *Drexel*, 960 F. 2d at 293 (citing *In re A.H. Robins Co.*, 880 F.2d 694, 701 (4th Cir.)). But it cited no section of the Bankruptcy Code that authorized this proposition. In its brief discussion of the objectors' challenge to the provision in the settlement agreement that barred members of subclass B from bringing or maintaining suits against DBL's officers and directors, the Court of Appeals, reasoning tautologically, said this:

The Settlement Agreement is unquestionably an essential element of Drexel's reorganization. In turn, the injunction is a key component of the Settlement Agreement. As the district court noted, the injunction limits the number of lawsuits that may be brought against Drexel's former directors and officers. This enables the directors and officers to settle those suits without fear that future suits will be filed. Without the injunction, the directors and officers would be less likely to settle. Thus, we hold that

the district court did not abuse its discretion in approving the injunction.

In re Drexel Burnham Lambert Grp., Inc., 960 F. 2d at 293. In other words, the Circuit held that the district court had discretion to approve non-debtor releases as part of the settlement of numerous securities fraud class actions in the context of a bankruptcy, simply and solely because funds were being funneled to the estate that would not otherwise be contributed.

There are numerous reasons why *Drexel* does not answer the question about a court's statutory authority under the Bankruptcy Code to release non-debtors over the objection of third parties who have direct claims against them. Two, however, are dispositive.

First and foremost, the Second Circuit simply did not address this question in *Drexel. Drexel* mentioned in passing something about a bankruptcy court's power to enjoin claims but did not identify any source of that power in the Bankruptcy Code. It appears to have assumed *sub silentio* that such authority existed.

Second, *Drexel* was decided two years before Congress passed Sections 524(g) and (h). The opinion's passing mention of a bankruptcy court's power to enjoin a creditor from suing a non-debtor became far less persuasive after Congress (1) amended the Bankruptcy Code to authorize such injunctions, but only in asbestos cases; (2) expressed agnosticism about whether any such authority existed outside of its new legislation; and (3) indicated its intent to consider at some later time whether to extend this authority to industries that were "reportedly experimenting" with such injunctions – which it never has. ⁶²

There are other reasons to question the continuing viability of *Drexel*. Whether its reasoning can be extended to mass tort cases like this one is highly dubious. Seven years after the Second Circuit's opinion in *Drexel*, the Supreme Court expressed grave doubt about whether the Rule 23(b)(1)(B) "limited fund class action" device that was employed in *Drexel* could ever be employed in the mass tort context like this one, *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 119 S.Ct. 2295, 144 L.Ed.2d 715 (1999). Subsequent to *Ortiz*, courts have consistently rejected attempts to apply the limited fund mandatory class action *98 device to mass torts. *See*, e.g., *In re Simon II Litig.*, 407 F.3d 125, 137-38 (2d Cir. 2005) (tobacco punitive damages litigation); *Doe v. Karadzic*, 192 F.R.D. 133, 140-44 (S.D.N.Y. 2000) (actions by victims of

war crimes committed by Bosnia–Herzegovina brought under the Alien Tort Claims Act).

Moreover, the Supreme Court also said in *Ortiz* that a fund which is "limited" only because the contributing party keeps a large portion of its wealth (*a la* the Sacklers) is "irreconcilable with the justification of necessity in denying any opportunity for withdrawal of class members whose jury trial rights will be compromised, whose damages will be capped, and whose payments will be delayed." *Ortiz v. Fibreboard Corp.*, 527 U.S. at 860, 119 S.Ct. 2295. The exact same thing could be said of the third parties whose claims are being extinguished as part of the Debtors' Plan.

Subsequent Second Circuit law in the Manville cases also casts doubt on a bankruptcy court's subject matter jurisdiction to authorize the release of third-party claims against the officers and directors of DBL simply because they would not otherwise have made a contribution to the debtor's estate. Manville III, 517 F.3d at 66. In Manville III/IV, the Second Circuit concluded that "a bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the res of the bankruptcy estate," and held that claims asserted against non-debtors that sought "to recover directly from [the] debtor's insurer for the insurer's own independent wrongdoing" did not have such impact. Manville III, 517 F.3d at 65-66. In so ruling the Second Circuit held it of no moment for jurisdictional purposes that the non-debtor was making made a financial contribution to a debtor's estate (id.), saying: "It was inappropriate for the bankruptcy court to enjoin claims brought against a third-party non-debtor solely on the basis of that third-party's financial contribution to a debtor's estate." Id. (Emphasis added) For this proposition, the Manville III panel cited with approval the Third Circuit's warning from *In re Combustion Engineering*, where the court had observed that:

a debtor could create subject matter jurisdiction over any on-debtor third-party [simply] by structuring a plan in such a way that it depended upon third party contribution. As we have made clear, subject matter jurisdiction cannot be conferred by consent of the parties. Where a court lacks subject matter jurisdiction over a dispute, the parties cannot create it by agreement even in a plan of reorganization.

In re Combustion Engineering, 391 F. 3d 190, 228 (3d Cir. 2004).

Finally, changes in class action law since *Drexel* was decided have rendered its facile analysis of the Rule 23(a) factors, especially commonality and typicality, highly

suspect. Amchem Products, Inc., v. Windsor, 521 U.S. 591, 117 S.Ct. 2231, 138 L.Ed.2d 689 (1997); Ortiz v. Fibreboard Corp., 527 U.S. 815, 119 S.Ct. 2295, 144 L.Ed.2d 715 (1999). I strongly suspect that the Drexel class certification, and so the Drexel settlement, would not and could not be approved today.⁶³

But one thing is clear: *Drexel* sheds no light whatsoever on the issue of whether releases like the one at bar are authorized *by the Bankruptcy Code*. That statute was never mentioned.

[44] New England Dairies/Metromedia: *99 In New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc., (In re Dairy Mart Conveniences Stores), 351 F. 3d 86, 92 (2d Cir. 2003), the Court of Appeals for this circuit definitively rejected the argument that § 105(a) of the Bankruptcy Code (see supra, at p. 94-95) could "create substantive rights that are otherwise unavailable under applicable law." As the author of the opinion (Judge Jacobs) recognized:

The equitable power conferred on the bankruptcy court by section 105(a) is the power to exercise equity in carrying out the *provisions* of the Bankruptcy Code, rather than to further the purposes of the Bankruptcy Code generally, or otherwise to do the right thing. This language "suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective." 2 *Collier on Bankruptcy* ¶ 105.01[1].⁶⁴

In re Dairy Mart Conveniences Stores, 351 F. 3d at 92.

In re Dairy Mart did not involve the confirmation of a plan containing non-debtor releases of third-party claims, so technically it did not speak to the question pending before this Court. But two years later, Judge Jacobs authored *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136 (2d Cir. 2005), which did.

Metromedia Fiber Network, Inc. and its subsidiaries declared bankruptcy. *See Metromedia*, 416 F.3d 136, 138 (2d. Cir. 2005). The company's founder, John W. Kluge, did not. However, as part of the plan of reorganization, Kluge, as grantor, established the "Kluge Trust." *Id.* at 141 n.4. Under the plan of reorganization proposed to the court, the Kluge Trust was to make "a 'material contribution' to the estate" in the bankruptcy, (*id.* at 143), by "[i] forgiv[ing] approximately \$150 million in unsecured claims against Metromedia; [ii] convert[ing] \$15.7 million in senior secured claims to equity in the Reorganized Debtors; [iii] invest[ing]

approximately \$12.1 million in the Reorganized Debtors; and [iv] purchas[ing] up to \$25 million of unsold common stock in the Reorganized Debtors' planned stock offering." *Id.* at 141. Metromedia itself would continue to exist after its reorganization – albeit under a new name, AboveNET – and to engage in the business of providing high bandwidth telecommunications circuits, which was its historic business model

In exchange for the Kluge Trust's contributions, the Kluge Trust and certain "Kluge Insiders" were to receive 10.8% of the Reorganized Debtors' common stock and something called the "Kluge Comprehensive Release." *Id.* The Kluge Comprehensive Release provided:

the Kluge Trust and each of the Kluge Insider shall receive a full and complete release, waiver and discharge from ... any holder of a claim of any nature ... of any and all claims, obligations, rights, causes of action and liabilities arising out of or in connection with any matter related to [Metromedia] or one or more subsidiaries ... based in whole or in part upon any act or omission or transaction taking place on or before the Effective Date.

Id.

The release was broad and did not carve out any exception – even for claims that could not be discharged against a debtor in *100 bankruptcy, such as those predicated on fraud or willful misconduct.

Following confirmation of the plan, appellant creditors Deutsche Bank AG (London Branch) and Bear, Stearns & Co., Inc. challenged the "largely implemented" plan of reorganization and argued that the releases in the plan of reorganization "improperly shield certain nondebtors from suit by the creditors." *Id.* at 138. On appeal, the district court both affirmed the plan of reorganization and ruled that the relief sought by the two banks was not "barred by the doctrine of equitable mootness because effective relief could have been afforded without 'unraveling the plan.'" *Id.* at 139.

The Second Circuit vacated the district court's affirmance of the plan, on the ground that the bankruptcy court had failed to make certain findings necessary to a determination that the non-consensual third-party releases should be approved. *Id.* at 143. But the plan had been substantially consummated by the time the appeal was heard, so the Circuit concluded that the matter was indeed equitably moot. As a result, it declined to remand so that a lower court could make the missing findings and reconsider the propriety of the releases. *Id.* at 145.

Before reaching this result, the panel discussed whether nondebtor releases were available in connection with someone else's bankruptcy. The Circuit identified "two considerations that justify ... reluctance to approve non-debtor releases." *Id.* at 141. It noted that such releases were not specifically authorized outside of the asbestos context:

[T]he only explicit authorization in the Bankruptcy Code for nondebtor releases is 11 U.S.C. § 524(g), which authorizes releases in asbestos cases when specified conditions are satisfied, including the creation of a trust to satisfy future claims ...

Metromedia Fiber Network, Inc., 416 F.3d at 142. And it held, consistent with In re Dairy Mart, that Section 105(a) of the Bankruptcy Code did not authorize the approval of such releases:

True, 11 U.S.C. § 105(a) authorizes the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]"; but section 105(a) does not allow the bankruptcy court "to create substantive rights that are otherwise unavailable under applicable law." New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (In re Dairy Mart Convenience Stores, Inc.), 351 F.3d 86, 92 (2d Cir.2003) (quotations and citation omitted). Any "power that a judge enjoys under § 105 must derive ultimately from some other provision of the Bankruptcy Code." Douglas G. Baird, Elements of Bankruptcy 6 (3d ed.2001); accord Dairy Mart, 351 F.3d at 92 ("Because no provision of the Bankruptcy Code may be successfully invoked in this case, section 105(a) affords [appellant] no independent relief."). Metromedia, 416 F. 3d at 142.

The panel also cautioned that courts should be careful about approving a non-consensual non-debtor release because the device "lends itself to abuse." *Id.* One particular form of abuse identified by the panel manifests when the release, in effect, "operate[s] as a bankruptcy discharge arrange without a filing and without the safeguards of the Bankruptcy Code." *Id.* Indeed, "The potential for abuse is heightened when releases afford blanket immunity." *Id.*

After observing that, "No case has tolerated nondebtor releases absent a finding of circumstances that may be characterized *101 as unique,." *Id.*, the panel listed circumstances in which such releases had been authorized in the past, and identified 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 the debtors' 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. However, the Circuit insisted that the ultimate decision about whether to authorize such releases was "not a matter of factors and prongs." Id. 142.

Having said all that, the Metromedia court did not rule on whether any or all of the factors it had identified were satisfied in the particular case before it. Nor did it conclude that a nondebtor release should be approved if the factors were satisfied, or consider whether, in the case before it, there might be other reasons why the proposed non-debtor releases should not be approved.

Instead, as noted above, the Circuit vacated approval of the plan and declined to remand for further consideration because the matter had become equitably moot – thereby guaranteeing that those open questions - including the question about whether there was statutory authority for such releases would not be answered.

So to summarize: No third-party releases were approved in Metromedia. The Court of Appeals did not conclude that such releases were consistent with or authorized by the Bankruptcy Code. It did not conclude that the case before it was one of the "unique" instances in which a court's reluctance to approve such releases might (assuming they were authorized) be overcome. And it did not decide whether the Kluge releases measured up to the level that might justify approving them if the case qualified as "unique." In re Metromedia Fiber Network, 416 F.3d at 142–143.

In other words, while Metromedia said a great deal, the case did not hold much of anything.⁶⁵ Its relevance, for present purposes, is that Judge Jacobs cautioned that statutory authority for non-consensual non-debtor releases outside of the asbestos context was at best uncertain – and then disposed of the case on other grounds, without identifying what section or sections of the Bankruptcy Code might actually authorize such relief in non-asbestos bankruptcy. 66

No subsequent Second Circuit case has filled in the blank.

*102 Manville III/IV and In re Quigley⁶⁷: These were asbestos cases, in which a court's statutory authority to impose such non-debtor injunctions is undoubted, as long as all the conditions listed in § 524(g) are met.

As discussed above, in Manville III/IV, the Second Circuit concluded that the bankruptcy court lacked subject matter jurisdiction over third party claims against Manville's nondebtor insurer that arose out of an alleged independent duty owed by the insurer to those third parties, rather than out of its contractual relationship as Manville's insurer. The court did not discuss any issue of statutory authority.

And in *Quigley*, the Circuit held that certain claims against the debtor's parent—claims based on the use of the parent's name on the debtors' asbestos products—could not be enjoined pursuant to § 524(g) because the alleged liability was not "by reason of" any of the four "statutory relationships" identified in that section. Quigley, 676 F.3d at 49, 60-61. Had the proposed injunction fallen within one of the express statutory relationships, it would have been authorized because the case involved asbestos.

Madoff: In re Bernard L. Madoff Inv. Securities LLC, 740 F.3d 81 (2d Cir. 2014) involved a chapter 7 liquidation under the Securities Investor Protection Act (SIPA). The debtor, Bernie L. Madoff Investment Securities ("BLMIS"), was an investment enterprise created to effect the Ponzi scheme of its principal, Bernie Madoff. The bankruptcy estate settled its claims against the estate of Jeffry M. Picower, an alleged Madoff co-conspirator, releasing its claims in exchange for a \$5 billion dollar contribution to Madoff bankruptcy estate. In addition to approving that settlement and release, the bankruptcy court permanently enjoined two of the debtor's customers from pursuing putative state tort law class actions against the estate of Jeffry M. Picower in the United States District Court for the Southern District of Florida, to the extent those claims arose from or related to the Madoff Ponzi scheme.

The Second Circuit affirmed the non-debtor injunction because the customer's complaints were predicated on secondary harms flowing from to them from BLMIS, and so were derivative claims that a bankruptcy court had power to discharge pursuant to Section 105(a). The Madoff court explained that the Florida plaintiffs had not alleged any direct claim against Picower's estate, because they failed to allege that Picower took any actions aimed at BLMIS customers (such as making misrepresentations to them) that caused particularized injury to those customers. Id. at 93.

However, the Second Circuit was careful to note that factual congruence between an estate's claim and an individual creditor's claim against the same non-debtor was not what rendered the asserted claims derivative. It held that, "there is nothing illogical or contradictory" about factual overlap between the allegations asserted in direct claim and a derivative claim; a non-debtor "might have inflected direct injuries on both the [estate's creditors] and [the debtor estate] during the course of dealings that form the backdrop of both sets of claims." *Id.* at 91 (quoting *In re Seven Seas Petroleum*, Inc., 522 F.3d 575, 587 (5th Cir. 2008)). A creditor could, therefore, bring a direct claim against a non-debtor, even though the debtor might have *103 suffered an identical injury – provided the creditor was not seeking to recover for injuries suffered by the debtor, but for injuries it suffered directly. Id.

Significantly for our purposes, the Second Circuit did not simply sweep away the Florida class actions; it permitted the creditors to amend their Florida complaints to assert direct claims if they could identify some direct injury that Picower caused them, as there was "conceivably some particularized claim" that the customers could assert against the non-debtor that could not also be asserted or released by the estate. *Id.* at 94.

Tronox: In re Tronox, Inc., 855 F.3d 84 (2d Cir. 2017) was not an asbestos case, but it adds nothing to the above discussion, for two reasons. First and foremost, the Court of Appeals dismissed the appeal for lack of appellate jurisdiction. Second, in that case, the claims asserted against the non-debtors by the third party were again derivative, not direct, claims (e.g., alter ego, piercing the corporate veil, and successor liability) – as in Madoff, the plaintiff alleged "no particularized injury" to the claimant. Id. Because success on a derivative claim benefits all creditors of the estate, the Circuit held that the bankruptcy "trustee is the proper person to assert the claim, and the creditors are bound by the outcome of the trustee's action." In re Tronox Inc., 855 F.3d at 103 (internal quotation omitted).

But the court went on to say that, "when creditors have a claim for injury that is particularized as to them, they are exclusively entitled to pursue that claim, and the bankruptcy estate is precluded from doing so." *Id.* at 99 (internal citation omitted). There was no discussion of enjoining such particularized claims, let alone any discussion of statutory authority for doing so.

Kirwan (Lynch v. Lapidem): And so we come to Lynch v. Lapidem (In re Kirwan Offs. S.à.R.L.) 792 Fed. Appx. 99 (2d Cir. 2019) ("Kirwan").

In *Kirwan*, the Second Circuit affirmed a bankruptcy court injunction that was included in a plan of reorganization in order to prevent collateral attacks on prior orders of that court. The appellant in *Kirwan* (Lynch) was one of three shareholders in the bankrupt enterprise. He challenged the *bona fides* of the bankruptcy filed by his former partners but lost after trial. The dissident shareholder then absented himself from the hearing on the plan of reorganization, of which he had notice. He did so in the (mistaken) belief that he could avoid any *res judicata* effect of the bankruptcy court's orders as long as he did not participate. *See In re Kirwan Offs. S.à.R.L.*, 592 B.R. 489, 501 (S.D.N.Y. 2018), *aff'd sub nom. In re Kirwan Offs. S.à.R.L.*, 792 F. App'x 99 (2d Cir. 2019).

Anticipating that the dissident shareholder would try to mount a collateral attack on the bankruptcy court's order confirming the plan, the other two shareholders had included therein a provision enjoining any person, including Lynch, from suing anyone in any forum on a claim arising out of the bankruptcy proceeding and the court-approved reorganization. Judge Drain confirmed the plan containing that provision. At the time he entered the order confirming the plan, the Bankruptcy Judge made it clear that Lynch's "opposition to any reasonable restructuring ... scurried, if not crossed the line, over into bad faith" (Kirwan, 592 B.R. at 499), and said it was "in that context ... that I am prepared to approve the exculpation and injunction provisions of the plan." Id. He specifically found that the provision was narrowly tailored and necessary in order to forestall "back-door attacks and collateral litigation for their activities related to *104 those things," which would impact the reorganized debtor as well the non-debtors who had proceeded in good faith throughout the bankruptcy.

In short, the injunction affirmed in *Kirwan* was plainly one designed to preserve and protect the authority of the bankruptcy court and the integrity of its actions *vis a vis* the debtor's estate. Unlike the third-party claims in this case, Lynch's claims against his erstwhile partnership inherently involved the property of the estate – the relief sought would have redistributed *post hoc* the estate following the bankruptcy court's confirmation of the plan.

As noted earlier (*see* footnote 56), Lynch did not argue, either in this Court or in the Second Circuit, that the injunction

was not statutorily authorized by the Bankruptcy Code. The grounds asserted and decided were jurisdictional and constitutional, not statutory. Neither this Court nor the Second Circuit analyzed the question of statutory authority, even in the context of the very limited and specially targeted injunction that was included in the debtor's plan.

<u>Summary of Second Circuit Law</u>: The only fair characterization of the law on the subject of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear. Because the Court of Appeals has decided every other case on non-statutory grounds, its only clear statement is that Section 105(a), standing alone, does not confer such authority on the bankruptcy court outside the asbestos context.

3. The Law in Other Circuits

All but three of the other Circuits have spoken directly to the issue of statutory authority. They have reached conflicting results – a most unfortunate circumstance when dealing with a supposedly uniform and comprehensive nationwide scheme to adjust debtor-creditor relations.

Three of the eleven Circuits – the Fifth, Ninth, and Tenth – reject entirely the notion that a court can authorize non-debtor releases outside the asbestos context. *See In re Pacific Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394, 1401-02 (9th Cir. 1995); *In re W. Real Estate Fund*, 922 F.2d 592, 600 (10th Cir. 1990). Those courts read § 524(e) as barring the granting of such relief – put otherwise, they under Congress' use of the phrase "Notwithstanding the provisions of § 524(e)" in § 524(g) as creating an exception to an otherwise applicable rule.

The Third Circuit also has not identified any section of the Bankruptcy Code that authorizes such non-debtor releases. Judge Drain points to *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 133-40 (3d Cir. 2019) (*In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40), but as in the Second Circuit cases like *Manville III/IV* and *Tronox*, the Third Circuit does not discuss statutory authority in that case. Instead, the *Millennium* court concluded that the bankruptcy court had *constitutional* authority to extinguish certain third-party claims by confirming a chapter 11 plan. *In re Millennium Lab Holdings II, LLC*, 945 F.3d 139-40.

On those occasions when the Third Circuit did address a bankruptcy court's statutory authority to impose non-debtor releases, it overturned bankruptcy court orders granting them. For example, in In re Continental Airlines, 203 F.3d 203 (3d Cir. 2000), the Court of Appeals rejected as extra-statutory the provision in a plan of reorganization that released claims against current and former directors of Continental, and that permanently enjoined shareholder actions against them, finding that the Bankruptcy Code "does *105 not explicitly authorize the release and permanent injunction of claims against non-debtors, except in one instance not applicable here" - that being asbestos cases. Id. at 211; 11 U.S.C. § 524(g). And in In re Combustion Engineering, Inc., 391 F.3d 190 (3d Cir. 2004), the Third Circuit, like the Second Circuit in Metromedia, held that Section 105(a) does not give the court the power to create substantive rights that would otherwise be unavailable under the Bankruptcy Code, and vacated the channeling injunction. Id. at 238. Neither Continental Airlines nor Combustion Engineering has ever been overruled by the Third Circuit.

The First, Eighth, and D.C. Circuits have yet to weigh in on the question of whether statutory authority to impose non-debtor releases exists. Judge Drain contends that the First Circuit did decide that issue, in *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F. 3d 973 (1st Cir. 1995), but again, the First Circuit did not identify any statutory authority to impose non-debtor releases in that case. It declined to decide whether Section 105(a) authorized the imposition of a non-debtor release; and it did not cite any other section of the Bankruptcy Code as conferring that authority. *Id.* at 983-94.

Judge Drain cited *In re AOV Indus., Inc.*, 792 F.2d 1140, 1153 (D.C. Cir. 1986) for the proposition that the D.C. Circuit has approved the non-consensual release of third-party claims against non-debtors. But that is wrong. The *AOV Industries* court did not say a word about whether such relief was authorized by statute. The court simply found that the issue before it – whether the bankruptcy court had *constitutional* authority to enter an order releasing non-debtor claims – was equitably moot. *Id.*

The Fourth and Eleventh Circuits have concluded that Section 105(a), without more, authorizes such releases. *See Nat'l Heritage Found., Inc. v. Highbourne Found., Inc.*, 760 F.3d 344, 350 (4th Cir. 2014); *In re Seaside Eng'g & Surveying*, 780 F.3d 1070, 1076-79 (11th Cir. 2015). After *In re Dairy Mart* and *Metromedia*, we know that is not the law in the Second Circuit. So Fourth and Eleventh Circuit law contradict

Second Circuit law, and cannot be relied on as authority for the proposition that such releases are statutorily authorized.

That leaves the Sixth and Seventh Circuits, both of which have concluded that Sections 105(a) and 1123(b)(6) of the Bankruptcy Code, read together, codify something that they call a bankruptcy court's "residual authority," and hold that a bankruptcy court can impose non-consensual releases of third-party claims against non-debtors in connection with a chapter 11 plan pursuant to that "residual authority." As discussed in my summary of his opinion, Judge Drain adopted the reasoning of these courts, and added two other sections of the Bankruptcy Code to buttress the analysis.

Summary of Extra-Circuit Law: A majority of the Circuits that have spoken to the statutory authority question either dismiss the idea that such authority exists or, as with the Second Circuit, (i) reject the notion that such authority can be found by looking solely to Section 105(a) and then (ii) fail to answer the question of where such authority can be found. Two Circuits rely solely on Section 105(a), and so have law that conflicts with the Second Circuit's pronouncement. Only two Circuits support the position taken by the learned Bankruptcy Judge.

*106 It is against that backdrop of higher court authority that I turn to the order on appeal.

C. The Statutory Provisions Upon Which the Bankruptcy Court Relied

Judge Drain was quite explicit about the statutory provisions that he believed gave him authority to approve these releases as "necessary or appropriate" to carry out the provisions of the Bankruptcy Code: Sections 105(a), 1123(a)(5) and (b)(6), and 1129, together with "residual authority." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *43.

The question that arises is whether any of the sections other than Section 105(a) confers some substantive right such that a release to enforce that right could be entered pursuant to Section 105(a).

I conclude that they do not.

Rather, each of the cited sections, like Section 105(a), confers on the Bankruptcy Court only the power to enter orders that carry out other, substantive provisions of the Bankruptcy Code. None of them creates any substantive right; neither do

they create some sort of "residual authority" that authorizes the action taken by the Bankruptcy Court.

Section 1123(b)(6): Subsections (a) and (b) of 11 U.S.C. § 1123, entitled "Contents of Plan," lay out in considerable detail what a plan of reorganization *must* (subsection (a)) and *may* (subsection (b)) contain in order to be confirmed.

We can quickly dispense with the notion that Section 1123(b) (6) provides the substantive authority for a Section 105(a) injunction or approval of a release.

[45] Section 1123(b)(6) provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title." 11 U.S.C § 1123(b)(6). In form, Section 1123(b)(6) is substantively analogous to Section 105(a)'s authorization of "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). If the latter does not confer any substantive authority on the bankruptcy court – and that proposition is well settled, at least in this Circuit – then the former can in no way be read to do so.

That alone would be reason to conclude that Section 1123(b) (6) does not provide the statutory authorization we are seeking. But as Appellants point out, various aspects of the non-consensual Section 10.7 Shareholder Release are indeed inconsistent with certain other provisions of title 11.

[46] First and foremost, the Section 10.7 Shareholder Release is inconsistent with the Bankruptcy Code because it discharges a non-debtor from debts that Congress specifically said could not be discharged by a debtor in bankruptcy. The Section 10.7 Shareholder Release does not carve out or exempt claims for fraud or willful and malicious conduct, liabilities from which Purdue cannot be discharged in its own bankruptcy. See 11 U.S.C. §§ 523(a)(2), (4), (6). Reading the Bankruptcy Code as authorizing a bankruptcy court to discharge a non-debtor from fraud liability – something it is strictly forbidden from doing for a debtor - cannot be squared with the fact that Congress intended that the Bankruptcy Code "ensure that all debts arising out of fraud are excepted from discharge no matter what their form." Archer v. Warner, 538 U.S. 314, 321, 123 S.Ct. 1462, 155 L.Ed.2d 454 (2003) (internal citation omitted). In other cases in which the releases at issue called for relief from suit that encompassed otherwise non-dischargeable claims, courts either ensured fraud claims were exempt from the releases before approving them, *107 In re Airadigm Commc'ns, Inc., 519 F.3d 640, 657 (7th Cir.

2008), or simply refused to approve the releases because they included otherwise non-dischargeable claims. See e.g., In re Fusion Connect, Inc., No. 20-05798, 2021 WL 3932346, at *7 (S.D.N.Y. Sept. 2, 2021) (reversing the bankruptcy court's decision to discharge a debtor from an outstanding civil penalty because liability "arising from fraud on consumers" and payable to a governmental entity is "nondischargeable" in a chapter 11 bankruptcy under Section 523(a)(2)). Aside from Drexel – which, for all the reasons discussed above, is probably no longer good law – the Second Circuit has never approved a non-consensual release of claims against non-debtors of this sort, nor has it ever explained what provision of the Bankruptcy Code authorizes a bankruptcy court to do so.

[47] Second, as the State Appellants point out, a debtor's discharge cannot relieve him of "any debt ... to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty..." 11 U.S.C. § 523(a)(7). At least some of the claims asserted by the State Appellants seek relief in the nature of non-dischargeable civil penalties payable to and for the benefit of governmental units. Such claims could not be discharged if the Sacklers had filed for personal bankruptcy.

To the extent that Judge Drain held that the Section 10.7 Shareholder Release was not inconsistent with these sections, I respectfully disagree.

Appellants also argue that the Section 10.7 Shareholder Release and corresponding injunctions are inconsistent with Section 524(e) of the Bankruptcy Code, which provides that "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). On the facts of this case, I cannot agree with that argument – but not because the Code is silent on the subject.

[48] Section 524(e) says, in sum and substance, that releasing a debtor on a debt owed to a creditor does not affect the liability that a non-debtor may have for the same debt. But the claims that would be released by the Section 10.7 Shareholder Release are not claims on which the Sacklers are jointly liable with Purdue. The various state statutes being invoked by Appellants give rise to Sackler liability *independent* of Purdue's liability – albeit for the very same violations of the very same laws – because those laws impose an independent duty on persons who occupy certain managerial positions in a corporation. We would not have this appeal if the Sackler

debts being eliminated by the Section 10.7 Shareholder Release were also debts owed by Purdue; we would be back in Section 10.6 land, dealing with derivative claims, where the Bankruptcy Court's power is unchallenged.

It is true that, when passing Section 524(g), Congress stated explicitly that the non-debtor releases therein authorized were being allowed "notwithstanding the provisions of sect. 524(e)." 11 U.S.C. § 524(g). It is hard to read that phrase and not conclude that Congress thought it was creating an exception to Section 524(e) by authorizing the release of third-party claims against non-debtors in certain limited circumstances.

However, back when Congress was considering § 524(g), it had before it a specific situation: the claims being released were against non-debtor insurance companies whose liability was premised on the conduct of their insureds that fell within the terms of the policies they had issued. Everything *108 that was being released was part and parcel of the bankruptcy estate; the debts owed by Manville and its insurers were the same debts; § 524(e) was obviously implicated. There is no indication, either in the text of the statute or in the legislative history, that Congress ever envisioned that a bankruptcy court could discharge the debts of non-debtors that were not also debts of the debtor. That being so, I cannot read the "notwithstanding" language to create an inconsistency on the facts of this case.

I am, therefore, constrained to conclude that the Section 10.7 Shareholder Release is not inconsistent with § 524(e), because it contains the discharge of debts that are not contemplated by § 524(e).

[49] Section 1123(a)(5): Section 1123(a)(5) of the Bankruptcy Code provides that a plan of reorganization must "provide adequate means for [its] implementation." 11 U.S.C. § 1123(a)(5). That section contains a laundry list of things that a plan can include in order to make sure that resources are available to implement the plan – any of which can be ordered by a bankruptcy court.

[50] Injunctions against the prosecution of third-party claims against non-debtors, and the release of such claims, are nowhere to be found on that list. Every single example listed in Subsections 5(A) through (J) authorizes the court to do something with the *debtor's assets* (retaining estate property; transfer of property; sale of property; satisfaction or modification of a lien; cancellation or modification of an

indenture or similar instrument; curing or waiving defaults; extension of maturity dates; issuing securities; even amending the debtor's charter). Since the bankruptcy court has *in rem* jurisdiction over the *res* of the debtor's estate, none of that should be surprising. It is equally unsurprising that none of the types of relief listed in Section 1123(a)(5) involves disposing of property belonging to someone other than the debtor or a creditor of the debtor. That is because it is the debtor's resources – not the resources of some third party – that are supposed to be used to implement a plan that will adjust the debtor's relations with its creditors.

Of course, this is not the first case in which the resources of non-debtors are being used to implement a plan; and § 1123(a) (5) does not pretend to contain an exhaustive list of all ways that a plan can provide means for its implementation. The Section begins, after all, with the words "such as." In this case, Debtors argue that the only way to get the resources necessary to implement a viable plan was to agree to the Sacklers' demand for broad releases in exchange for their contribution of money to the bankruptcy estate. They insist that the Section 10.7 Shareholder Release and corresponding injunctions carry out the requirements of Section 1123(a)(5) by ensuring that the Plan has the funding it needs - and if that funding was obtained from some third-party funder on condition of a release and an injunction, then those forms of relief are authorized because the money is needed to fund the Plan.

But the fact that Purdue needs the Sacklers to give the money back does not mean that Section 1123(a)(5) confers on the Debtors or the Sacklers any right to have the non-debtors receive a release from non-derivative third-party claims in exchange for a contribution to Purdue's estate. The Debtors' suggestion that this Section confers some substantive right is exactly the sort of circular reasoning that was rejected by Judge Jacobs where Section 105(a) was concerned. See In re Dairy Mart, 351 F.3d at 92 (any such power conferred by Section 105(a) must "be tied *109 to another Bankruptcy Code section and not merely to a general bankruptcy encept or objective") (quoting 2 Collier on Bankruptcy ¶ 105.01[1]). Getting to a confirmable plan is the general bankruptcy objective, nothing more.

[51] Nor does Section 1123(a)(5) confer any special power on the Bankruptcy Court. A court does not propose the plan; the debtor and its creditors put the plan together and present it to the court, which cannot approve the plan unless it contains the required provisions and need not approve it even then.

To the extent that any court order is contemplated by Section 1123(a), it is the Confirmation Order – not an injunction and release of claims against non-debtors in order to obtaining funding for a plan, which is essentially what Debtors are proposing.

[53] Finally, and most important, Section 1123(a) (5) does not authorize a court to give its imprimatur to something the Bankruptcy Code does not otherwise authorize, simply because doing so would ensure funding for a plan. Nothing in Section 1123(a)(5) suggests that a debtor has the right to secure sufficient funds for implementation by any means necessary. Section 1123(a)(5) would not, for example, authorize a court to enter an order enjoining a bank from suing a non-debtor employee who embezzled funds and then offered them to her bankrupt brother's estate in exchange for a release of all claims a third party could assert against her. That example is silly, of course, but the point is simple: the mere fact that the money is being used to fund implementation of the plan does give a bankruptcy court statutory authority to enter an otherwise impermissible order in order to obtain that funding. As was the case with Section 1123(b)(6), Judge Drain's reliance on Section 1123(a) (5) begs the ultimate question that must be answered: whether the court has some independent statutory authority to issue the non-debtor releases and enjoin third party claims against the Sacklers, such that the Bankruptcy Court can enter a "necessary and appropriate" order to obtain the funding.

[54] Section 1129(a)(1): Finally, Section 1129(a)(1) does not provide the substantive authority for a Section 105(a) injunction or approval of a release. Section 1129 is entitled "Confirmation of plan," and Subsection 1129(a)(1) provides that a bankruptcy court "shall confirm a plan only if ... the plan complies with the applicable provisions of this title." 11 U.S.C.A. § 1129. Like the cited sections of § 1123, § 1129(a) confers no substantive right that could be used to undergird a § 105(a) injunction. One highly general provision simply does not confer substantive authority that is required to invoke another highly general provision.

Lack of Any Statutory Prohibition: Having exhausted the statutory provisions on which Judge Drain relied and finding that none of them confers any substantive right as required by *Metromedia*, our exercise should be at an end. But it is not. The Debtors argue that the Bankruptcy Court must be statutorily authorized to approve these releases because no provision of the Bankruptcy Code – including but not limited to § 524(e) – expressly prohibits them.

The notion that statutory authority can be inferred from Congressional silence is counterintuitive when, as with the Bankruptcy Code, Congress put together a "comprehensive scheme" designed to target "specific problems with specific solutions." *RadLAX Gateway Hotel*, 566 U.S. at 645, 132 S.Ct. 2065. In this particular case, a number of red flags suggest that Congressional silence (if indeed Congress *110 was silent) was not intended to mean consent.

[55] The first is that silence is inconsistent with comprehensiveness, and the Bankruptcy Code "provides a *comprehensive* federal system ... to govern the orderly conduct of debtors' affairs and creditors' rights." *E. Equip. & Servs. Corp. v. Factory Point Nat. Bank, Bennington*, 236 F.3d 117, 120 (2d Cir. 2001) (emphasis added). "Comprehensive" means "complete, including all elements." Reading elements that do not appear in the text of the Code into the Code is the antithesis of comprehensiveness.

Then-District Judge Sullivan recognized as much in In re Lehman Bros. Holdings Inc., 508 B.R. 283 (S.D.N.Y. 2014). There, the bankruptcy court granted a certain creditor's application for reimbursement of post-petition counsel fees over the U.S. Trustee's objection that the Bankruptcy Code only permitted reimbursement of post-petition administrative expenses. On appeal, Judge Sullivan was not persuaded by appellees' argument that reimbursement for professional fees was authorized by the Bankruptcy Code simply because nothing in the Bankruptcy Code expressly forbade it. He held that, "no such explicit prohibition is necessary" because the requested reimbursement clearly goes against the purpose of a reorganization - "Reorganization plans exist to pay claims ... [the] professional fee expenses were all incurred post-petition, and thus cannot be treated as 'claims.' " Id. at 293. He further noted that the federal bankruptcy scheme "cannot remain comprehensive if interested parties and bankruptcy courts in each case are free to tweak the law to fit their preferences." In re Lehman Bros. Holdings Inc., 508 B.R. 283, 294 (S.D.N.Y. 2014) (internal citations omitted).

As I noted above, Justice Breyer recently wrote when discussing the priority scheme set out in the Bankruptcy Code, the importance of certain critical aspects of the bankruptcy scheme "leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure." *Jevic Holdings Corp.*, 137 S. Ct. at 984. Granting releases to non-debtors for claims that could not be released in favor of the debtors themselves is so far outside the scope of the

Bankruptcy Code and the purposes of bankruptcy that the "silence does not necessarily mean consent" principle applies with equal force.

[56] Second, it is hard to infer consent from silence in circumstances when one would not expect Congress to speak. The Code was intended "to free the debtor of his personal obligations while ensuring that no one else reaps a similar benefit" Green v. Welsh, 956 F.2d 30, 33 (2d Cir. 1992) (emphasis added). It is counterintuitive to imagine that Congress would have thought it necessary to include language specifically forbidding things that that ran counter to that purpose. As one of Judge Drain's colleagues recently reminded us, the ordering of an involuntary release of thirdparty claims against non-debtors is "an extraordinary thing" that is "different ... from what courts ordinarily do." In re Aegean Marine Petroleum Network Inc., 599 B.R. 717, 723 (S.D.N.Y. 2019). That is especially true where, as is proposed here, we find ourselves in what Judge Wiles called "the odd situation where we are being asked to use an unwritten authority to release non-debtor officers and directors from claims when the Bankruptcy Code would bar us from giving similar relief to those persons if they were debtors in their own cases." Id. at 726 (citing Metromedia, 416 F.3d at 142).

Third, Congress has in fact spoken on this subject, and what it has said suggests that it intended Sections 524(g) and (h) to preempt the field where non-debtor releases *111 were concerned. I will not repeat the extensive discussion about the law and its legislative history that appears above, except to say that Congress in its wisdom elected to limit Code-based authority to release third party claims against non-debtors to asbestos litigation – and it declined either to agree with those who argued that bankruptcy courts already had a broader power to authorize such releases. Congress was not unaware that there were non-asbestos bankruptcies with thousands of claimants and nationwide implications in the early 1990s. Other mass tort bankruptcies with thousands upon thousands of potential claimants were pending (i.e., in A.H. Robins/ Dalkon Shield), as was the highly publicized bankruptcy of a major investment bank (*Drexel*). The Judiciary Committee mentioned the "experimentation" with Manville-like relief that was beginning in other industries.

Yet Congress declined to make this extraordinary form of relief – relief that ran counter to the fundamental purpose of the Bankruptcy Code – available in circumstances other than asbestos bankruptcies. And it reserved for itself the right to change that.

So the silence that speaks volumes is not Congress' failure to say, "And you can't give involuntary non-debtor releases to anyone except in an asbestos case." The silence that speaks volumes is the twenty-seven years of unbroken silence that have passed since Congress said, "We are limiting this to asbestos for now, and maybe, when we see how it works in that context, we will extend it later."

[57] Fourth, but by no means least, "it is a commonplace of statutory construction that the specific governs the general." *RadLAX Gateway Hotel*, 504 U.S. at 384. The Supreme Court of the United States has relied on that principle on multiple occasions in refusing to allow generalized provisions of the Bankruptcy Code to override specific directives on a particular subject.

Take, for example, *RadLAX* itself. The plan proposed by the debtors in *RadLAX* provided for the sale of unencumbered assets securing a bank creditor's claim free and clear of all liens. But, in contravention of the provision governing such a "cram down" plan under the Bankruptcy Code, the bid procedures proposed by the debtors precluded the bank holding the mortgage on the property from credit-bidding the amount of its claim, which the Bankruptcy Code specifically authorized the bank to do. 11 U.S.C. § 1129(b)(2)(A)(ii). Nonetheless, the bankruptcy court approved the plan. It agreed with the debtors that the bank did not need to be permitted to bid on the property as long as it was provided with the "indubitable equivalent" of its claim in some other fashion – in this particular case, the cash generated by the auction. 11 U.S.C. § 1129(b)(2)(A)(i)-(iii).

[58] The Supreme Court rejected the debtors' justification, holding that the "indubitable equivalents" subclause (subclause iii) was a general subclause that could not be used to circumvent the specific requirement of subclause (ii) that the bank be permitted to credit-bid at the sale. The Court stated that the debtors' reading of the statute – that clause (iii) permits precisely what clause (ii) proscribes – is "hyperliterally contrary to common sense." *RadLAX Gateway Hotel*, 566 U.S. at 640, 132 S.Ct. 2065. The Court called it "axiomatic" that specific statutory provisions control over general provisions and emphasized that the "general/ specific canon" applies with particular force in bankruptcy, because "Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions." *Id*.

*112 Where, as here, Congress has deliberately limited a specific targeted solution (the release of third-party claims against non-debtors) to a specific identified problem (asbestos bankruptcies) – and has even denominated that solution as an exception to the usual rule – *RadLAX* strongly suggests that the general/specific canon should apply with particular force.

Ginsberg & Sons v. Popkin, 285 U.S. 204, 52 S.Ct. 322, 76 L.Ed. 704 (1932) is a pre-Code case, but it illustrates the same principle. There, petitioner argued that Clause 15 of Section 2 of the Bankruptcy Act empowered district judges to issue orders directing the arrest of the former officers and directors of the debtor. Clause 15 provided, "The courts of bankruptcy are hereby invested with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings ... [t]o] make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this title." Section 2, 11 USCA s 11(15). The reader will immediately appreciate that Clause 15 is the Bankruptcy Act's equivalent of Section 105(a) of the Bankruptcy Code - it was the "necessary and appropriate" clause in the old statutory scheme.

But Section 9(a) of the Bankruptcy Act specifically precluded "a court of bankruptcy" from directing the arrest of former directors and officers, except for contempt or disobedience of its lawful orders. And Section 9(b) prescribed in great detail the conditions to and procedures for invoking the exception under which the court could direct the arrest and detention of such former directors and officers who posed a flight risk.

The Supreme Court refused to read Clause 15 of Section 2 in a way that would render the specific prohibitions and procedures enumerated in Sections 9(a) and (b) superfluous: "In view of the general exemption of bankrupts from arrest under section 9a and the carefully guarded exception made by section 9b as to those about to leave the district to avoid examination, there is no support for petitioner's contention that the general language of section 2(15) is a limitation upon section 9(b) or grants additional authority in respect of arrests of bankrupts." *D. Ginsberg & Sons v. Popkin*, 285 U.S. at 207–08, 52 S.Ct. 322.

The Supreme Court's holdings in these cases old and new are instructive in the present context. Here, Debtors and their allies seek to apply general provisions – Sections 105(a) and 1123(a)(5) and (b)(6) – to justify expanding the

express authority conferred by Congress under § 524(g) into a situation that is manifestly not comprehended by that statute. Because the specific controls the general, that reliance is misplaced.

For all these reasons, I cannot conclude that Congressional "silence" should be deemed consent to an expansion of Section 524(g). In fact, I do not believe that Congress has been silent at all. But to the extent it has, its silence supports the Appellants' position, not the Debtors'.

Residual Authority: Finally, I turn to the concept of "residual statutory authority." In these circumstances, I conclude that such authority simply does not exist.

Judge Drain framed the question before him as, "whether the court has statutory *or other power* to confirm a plan with a third-party claim release," and, if so, "what is the statutory *or other source of power* for such a release?" *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *40, *43 (emphasis added). He identified the "other source of power" as the residual power of bankruptcy courts.

*113 [59] But such power, if it even exists, is of no help where, as here, it is being exercised in contravention of specific provisions of the Bankruptcy Code.

Debtors rely heavily on the Supreme Court's decision in In re Energy Resources Co, 495 U.S. 545, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990) for the proposition that a bankruptcy court has "residual authority" to approve reorganization plans that includes all "necessary and appropriate" provisions, as long as those provisions are not inconsistent with title 11. In that case, the Court concluded that two bankruptcy courts - which were forbidden by the Bankruptcy Code from discharging a tax debt⁶⁹ and required not to confirm a plan unless satisfied that the IRS would in all likelihood be able to collect taxes owed within six years ⁷⁰ – had not "transgressed" one of the limitations on their equitable power" by directing in a plan of reorganization that certain tax payments be credited in the first instance to so-called "trust fund" tax debt, and only when that debt was satisfied to so-called "non-trust fund" tax debt. In re Energy Resources Co., 495 U.S. 499-50. Trust fund tax debt is guaranteed by third parties; an order directing that the guaranteed debt be paid first meant that if there were any unpaid taxes at the end of the plan period, the IRS could probably not look to third parties for payment. The IRS argued that this provision of the plan was inconsistent with the Bankruptcy Code, because requiring the debtor to pay nontrust fund taxes first would give the IRS a greater chance of recovering 100 cents on the dollar.

But the Supreme Court ruled that the Bankruptcy Code did not require that a plan of reorganization be structured so that the unsecured tax debt was paid first. The bankruptcy court had found (as required by the Bankruptcy Code) that the plan of reorganization proposed by the debtors was likely to succeed. It further found that, if the plan did succeed, all taxes would be fully paid within six years. The express terms of the Bankruptcy Code required nothing more. Therefore, the order directing that tax payments be credited first to back taxes secured by the trust fund, and then to unsecured back taxes, was not inconsistent with any applicable provision of title 11. All the substantive guarantees that the Bankruptcy Code afforded to the IRS were baked into the court's approval of the plan.

No reference in *Energy Resources* to a bankruptcy court's "residual power" authorizes the learned Bankruptcy Judge's approval of the Section 10.7 Shareholder Release under any "residual power" theory. Just two years prior to the In re Energy Resources decision, the same Supreme Court – made up of the same nine justices – held that the bankruptcy court's residual equitable authority was bounded by the provisions of the Bankruptcy Code. Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169 (1988) (holding "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code"). *Energy Resources* is consistent with this principle. Congress legislated a particular right into the Bankruptcy Code; the Supreme Court refused to allow lower courts to expand that right and held that the Bankruptcy Court had the power to authorize anything that was not inconsistent with that right. But the Bankruptcy Code conferred a specific right. In this case, there is nothing in the Bankruptcy Code that specifically authorizes the Section 10.7 Shareholder Release; *114 the Bankruptcy Court (and this Court) is being asked to insert a right that does not appear in the Bankruptcy Code in order to achieve a bankruptcy objective. That is precisely what In re Dairy Mart and *Metromedia* prohibit.

Additionally, the *Energy Resources* Court, echoing its own holding of two years earlier, recognized that any residuary power enjoyed by a bankruptcy court must be exercised in a way that "is not inconsistent with the applicable provisions of this title." I have become convinced, for the reasons discussed in great detail above, that the Section 10.7 non-debtor releases

are in fact inconsistent with applicable provisions of title 11 - with Sections 524 (g) and (h), with Section 523, and with Section 1141(d), and possibly even with Section 524(e). Therefore, no residual power can authorize such an order.

As a corollary to the "residual authority" argument, several Appellees argue the release of claims against the non-debtor Sacklers and their related entities are proper because the Bankruptcy Code, taken as a whole, creates a "special remedial scheme" in which certain legal proceedings may terminate preexisting rights if the scheme is otherwise consistent with due process. They cite Martin v. Wilks, 490 U.S. 755, 109 S.Ct. 2180, 104 L.Ed.2d 835 (1989) for their proposition.

In Martin v. Wilks, the Supreme Court announced that, as a general rule, "A judgment or decree among parties to a lawsuit resolves issues as among them, but it does not conclude the rights of strangers to those proceedings." It affirmed the Eleventh Circuit's judgment allowing certain individuals who were not parties to an original action to challenge consent decrees entered in that original case. *Id.* at 762, 109 S.Ct. 2180. But, in a footnote, the Court acknowledged an exception to the general rule exists "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." Id. at 762, 109 S.Ct. 2180, n. 2.

[60] [61] [62] Judge Drain did not adopt this reasoning or function of where a bankruptcy filing is made. rest his view about his statutory authority on the Bankruptcy Code's "special remedial scheme" – and rightly so, because it is contrary to Second Circuit law. The "special remedial scheme" contemplated by the Bankruptcy Code addresses the rights of persons who have claims against a debtor in bankruptcy - not claims against other non-debtors. The Code lays out a claims allowance process so that creditors can file their claims against someone who has invoked the protection of the Bankruptcy Code; it provides a mechanism for those parties to litigate those claims against the debtor and to determine their value. In order to take advantage of this "special remedial scheme," debtors have to declare bankruptcy, disclose their assets, and apply them – all of them, with de minimis exceptions – to the resolution of the claims of their creditors.

Non-debtors have no such obligations, and so do not have any rights at all under the "special remedial scheme" that is bankruptcy - certainly not the "right" to have claims that are being asserted against them outside the bankruptcy process released. As the Second Circuit held in Manville III, the "special remedial scheme" due process exception relating to in rem bankruptcy proceedings simply does not give a bankruptcy court subject matter jurisdiction to release in personam third-party claims against a non-debtor. In re Johns-Manville Corp., 600 F. 3d 135, 158 (2d Cir. 2010).

*115 Conclusion: No Statutory Authority. In Metromedia, the Second Circuit signaled that a Bankruptcy Code could not order the non-consensual release of third-party claims against non-debtors unless some provision of the Bankruptcy Code aside from Section 105(a) authorized it to do so. For the reasons stated above, I conclude that there is no such section, and so no such authority.

It is indeed unfortunate that that this decision comes very late in a process that, from its earliest days in 2019, has proceeded on the assumption that releases of the sort contemplated in Section 10.7 of the Debtors' Plan would be authorized – this despite the language of the Bankruptcy Code and the lack of any clear ruling to that effect. I am sure that the last few years would have proceeded in a very different way if the parties had thought otherwise. But that is why the time to resolve this question for once and for all is now – for this bankruptcy, and for the sake of future bankruptcies. It should not be left to debtors and their creditors to guess whether such releases are statutorily authorized; and it most certainly should not be the case that their availability, or lack of same, should be a

[63] I also acknowledge that the invalidating of these releases will almost certainly lead to the undoing of a carefully crafted plan that would bring about many wonderful things, including especially the funding of desperately needed programs to counter opioid addiction. But just as, "A court's ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions" (Manville III, 517 F.3d at 66), so too its power to grant relief to a non-debtor from non-derivative third party claims "can only be exercised within the confines of the Bankruptcy Code." Norwest Bank Worthington, 485 U.S. at 206, 108 S.Ct. 963.

Because the Bankruptcy Code confers no such authority, the order confirming the Plan must be vacated. Because the Advance Order is an adjunct of and follows from the Confirmation Order, it, too, must be vacated.⁷¹

III. The Plan's Classification and Treatment of the Canadian Appellants' Claims Does Not Violate the Bankruptcy Code.

Because the court reverses on the ground that there is no statutory authorization in the Bankruptcy Code for the Bankruptcy Court to impose a non-voluntary release of third-party claims against non-debtors, I do not reach the Canadian Appellants' separate attack on the Section 10.7 Shareholder Release. But part of the Canadian Appellants' argument on appeal is that the Plan as confirmed violates the Bankruptcy Code by treating the Canadian Appellants' unsecured claims unfavorably as compared to the claims of their domestic counterpart creditors. The Canadian Appellants explained at Oral Argument that this "inequality" issue must be decided, regardless of how the court ruled on the Section 10.7 Shareholder Release. (See Oral Arg. Tr., Nov. 30, 2021, at 71:6-21).

[64] Pursuant to the Plan, the Canadian Appellants are entitled to a share of the *116 \$15 million dollars distributed to a trust that will be divided among all of the general unsecured creditors of the Debtor. (Dkt. No. 59, at 47). At the same time, domestic government and tribe unsecured creditors are not classified as "general" unsecured creditors but are placed in classes 4 and 5 as "Non-Federal Domestic Governmental" claimants and "Tribe" claimants respectively. (See Plan, at 2). The Canadian Appellants argue that the Bankruptcy Code contains an "equal-treatment mandate" in Section 1129(a)(4) requiring that "all creditors within the same class enjoy the same 'opportunity' to recover." (Dkt. No. 59, at 47). Because, they argue, the domestic nonfederal government claims (Class 4) and tribal claims (Class 5) are "indistinguishable" from theirs (id.), the Canadian Appellants posit that they are "similarly situated" to their "domestic counterparts" and thus should be part of the same creditor "class." Since the Plan does not allow the Canadian Appellants to "enjoy shares in trusts seeded with \$4.5 billion -300 times as much" as would be available to the general unsecured creditors of Purdue (Id.) – the Canadian Appellants argue that there exists "an inequality that is independently fatal to the Plan's treatment of the Canadian Appellants' claims." (Id.).

[65] The Court disagrees. Under the Plan, the Canadian Appellants belong to a different class than their domestic, unsecured creditor "counterparts" for perfectly legitimate reasons. The Code does not require that all creditor classes be treated equally, only that there be a reasonable basis for any differentiation. See Boston Post Rd. Ltd. P'ship v. FDIC (In

re Boston Post Rd. Ltd. P'ship), 21 F.3d 477, 482-83 (2d Cir. 1994).

[66] [67] [68] First, the Bankruptcy Code expressly permits differentiation *between* classes of creditors and the Canadian Appellants rightly recognize that their "equaltreatment mandate" applies only to claims of "all creditors within the same class." (*See* Dkt. No. 59, at 47). The Canadian Appellants' argument that they are of the same "class" as the non-federal government and tribe claimants is unconvincing. It does not matter that the Canadian Appellants' claims are purportedly "indistinguishable" from those held by the domestic unsecured creditors in Classes 4 and 5; a chapter 11 plan may separately classify similar claims so long as the classification scheme has a reasonable basis for doing so. *See In re Boston Post Rd. Ltd. P'ship*, 21 F.3d at 482-83.

In Boston Post Rd. Ltd. P'ship, the chapter 11 plan classified unsecured claims against the insolvent Debtor, the Boston Post Road Limited Partnership ("BRP"), differently between the Federal Deposit Insurance Corporation ("FDIC") and BPR's other trade creditors. The classification treated the unsecured trade creditors more favorably than FDIC, while FDIC was BPR's largest unsecured creditor and an anticipated objector to the plan; the differentiation between these classes was done to achieve a "cramdown" of the plan over FDIC's objections. Id. at 479. The bankruptcy court denied confirmation of a chapter 11 plan on the basis that the plan impermissibly separately classified similar claims, holding that FDIC's unsecured claims should have been placed in the same class with other unsecured creditors, and the District Court affirmed. Id. On appeal, the Second Circuit found that the "Debtor was unable and failed to adduce credible proof of any legitimate reason for segregating the FDIC's unsecured claim from the unsecured claims of BPR's trade creditors." *Id.* at 483. The Debtor's only reasons were that the FDIC's claim purportedly "were created from different circumstances" and "BPR's future viability as a business depends on treating its trade *117 creditors more favorably than the FDIC." Id. These reasons were "availing" to the Circuit. Id. In particular, the Circuit took issue with classifying similar claims differently "in order to gerrymander an affirmative vote on a reorganization plan." Id. at 482-83 (quotation omitted). The Circuit explained, "approving a plan that aims to disenfranchise the overwhelmingly largest creditor through artificial classification is simply inconsistent with the principles underlying the Bankruptcy Code." Id.

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

[69] In this case, unlike in Boston Post Rd. Judge Drain identified a reasonable basis for separately classifying the Canadian Appellants from the domestic unsecured creditors: First, Judge Drain explained that the Canadian creditors operate under "different regulatory regimes ... with regard to opioids and abatement" than their domestic counterparts. In re Purdue Pharma L.P., 2021 WL 4240974, at *12. Second, Judge Drain explained that "the allocation mediation conducted by Messrs. Feinberg and Phillips that resulted in the plan's division of the Debtors' assets ... involved only U.S.-based public claimants with their own regulatory interests and characteristics." Id. (emphasis added). As the Debtors point out, the Canadian Appellants themselves differentiate themselves from the other classes in this manner, explaining (i) "[t]he Canadian Appellants are in Canada, [(ii)] the bulk of their legal claims arise in Canada, [(iii)] those claims concern the operations of Purdue Canada," and (iv) the Canadian Appellants' claims "bear no relation to the Shareholder Released Parties' control, direction, and oversight of the Debtors or their U.S. operations." (Dkt. No. 59, at 17-18; Dkt. No. 151, at 120-121). That very classification on the part of the Canadian Appellants accords with Judge Drain's findings that there is a reasonable basis for the separate classifications. And there is no argument that such separate classification was done for the purpose of disenfranchising a particular group in a manner inconsistent with the Bankruptcy Code, to engineer an assenting impaired class; or manipulate class voting, all of which must be carefully scrutinized by the court. Indeed, it was not.

Under the Plan, the Canadian creditors are classified in Class 11(c), while the domestic municipalities and domestic Indian tribes are classified as Class 4 and 5 creditors. These are perfectly legitimate classifications and the proffered reasons for doing so are reasonable. And the Canadian Appellants do not (and cannot) argue that under the Plan their claims will receive unequal treatment as compared to other claims in their class, Class 11(c), as indeed all claims classified as Class 11(c) are treated equally under the Plan. (Dkt. No. 59, at 44, 47-48).

[70] Finally, Canadian Appellants *cannot* argue that their Class 11(c) claims are treated unfavorably as compared the

other creditor classes (like Class 4 and/or Class 5) because their class, Class 11(c), voted to accept the Plan. Under the Bankruptcy Code, only creditors of a *dissenting* class can object to the confirmation of a plan on the grounds that the plan discriminates against its creditor class. Pursuant to section 1129(b)(1) of the Bankruptcy Code, a plan shall be confirmed "if the plan does not discriminate unfairly ... with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b) (1). Because the Canadian creditors – as part of Class 11(c) – voted to accept the Plan, the Canadian Appellants cannot contend that they are being treated unfavorably.

The classification and treatment of the Canadian Appellants' claims under the *118 Plan does not violate the Bankruptcy Code.

CONCLUSION

For the foregoing reasons, the Bankruptcy Court's Confirmation Order and related Advance Order must be vacated.

This decision leaves on the table a number of critically important issues that were briefed and argued on appeal – principal among them, whether the Section 10.7 Shareholder Release can or should be approved on the peculiar facts of this case, assuming all the other legal challenges to their validity were resolved in Debtors' favor.

But sufficient unto the day. This and the other issues raised by the parties can be addressed if they need to be addressed – which is to say, if this ruling is reversed.

This constitutes the decision and order of the court. This is a written opinion.

All Citations

635 B.R. 26

Footnotes

Purdue Pharma Inc. ("PPI"), Purdue Transdermal Technologies L.P., Purdue Pharma Manufacturing L.P., Purdue Pharmaceuticals L.P., Imbrium Therapeutics L.P., Adlon Therapeutics L.P., Greenfield BioVentures L.P., Seven Seas Hill Corp., Ophir Green Corp., Purdue Pharma of Puerto Rico, Avrio Health L.P., Purdue Pharmaceutical Products L.P., Purdue Neuroscience Company, Nayatt Cove Lifescience Inc., Button Land L.P., Rhodes Associates L.P., Paul Land

2022 SOUTHEAST BANKRUPTCY WORKSHOP

- Inc., Quidnick Land L.P., Rhodes Pharmaceuticals L.P., Rhodes Technologies, UDF LP, SVC Pharma LP, and SVC Pharma Inc. (together, the "Debtors" or "Purdue").
- The Sackler family in this opinion means the Mortimer D. Sackler Family (also known as "Side A" of the Sackler family) and the Raymond R. Sackler Family (also known as "Side B" of the Sackler family).
- 3 The Plan refers to confirmed chapter 11 bankruptcy plan of reorganization at Bankruptcy Docket Number 3726. (See Dkt. No. 91-3, at App.1070-1227).
- It is true that many members of some creditor classes did not cast a vote, but the law provides that a plan must be approved, not by a supermajority of all eligible voters, but by a supermajority of all actual voters. 11 U.S.C. § 1126. That being so, there is no merit to Appellants' argument that the court should not deem the Plan approved by a supermajority of the affected creditor classes.
- 5 While the City of Seattle objected to the Plan before the Bankruptcy Court, it did not appeal.
- The U.S. Trustee "is a DOJ official appointed by the Attorney General to supervise the administration of bankruptcy cases" and has standing under 11 U.S.C. § 307 to appear in bankruptcy cases and "comment on proposed disclosure statements and chapter 11 plans." (Dkt. No. 91, at 8 (citing 28 U.S.C. §§ 581-589 and 28 U.S.C. § 586(a)(3)(B)).
- 7 Ilene Sackler Lefcourt, Kathe Sackler, Mortimer D.A. Sackler, Theresa Sackler, Richard Sackler, Jonathan Sackler, and David Sackler were at some or all relevant times directors of Purdue and its related enterprises. Mortimer D. Sackler and Raymond Sackler had management roles at the company as co-chief executive officers; Richard Sackler also served as president; and Mortimer D.A. Sackler, Ilene Sackler Lefcourt, and Kathe Sackler held officer roles as vice presidents. Mariana Sackler worked at Purdue in research and development.
- In this decision, docket numbers abbreviated "Dkt. No." refer to the consolidated docketed appeals at 7:21-cv-7532; docket numbers abbreviated "Bankr. Dkt. No." refer to the underlying bankruptcy docket at 19-23649.
- The UCC is also referred to in court filings and the appellate record as the "Creditors' Committee." The Court uses the terminology "UCC" consistent with the language provided in the glossary at Docket Number 115-1.
- The AHC is also referred to in court filings and the appellate record as the "Ad Hoc Committee." The Court uses the terminology "AHC" consistent with the language provided in the glossary at Docket Number 115-1.
- 11 See Garber v. Legg Mason Inc., 347 F. App'x 665, 669 (2d Cir. 2009) (" '[a] court may take judicial notice, whether requested or not.' ") (quoting Fed. R. Evid. 201(c)); Hotel Emps. & Rest. Emps. Union, Local 100 of New York, N.Y. & Vicinity, AFL-CIO v. City of NY Dep't of Parks & Recreation, 311 F.3d 534, 540 n.1 (2d Cir. 2002) (" 'Judicial notice may be taken at any stage of the proceeding.' ") (quoting Fed. R. Evid. 201(d)); Schenk v. Citibank/Citigroup/Citicorp, No. 10-CV-5056 (SAS), 2010 WL 5094360, at *2 (S.D.N.Y. Dec. 9, 2010) (citing Anderson v. Rochester–Genesee Reg'l Transp. Auth., 337 F.3d 201, 205 n.4 (2d Cir. 2003)) ("Judicial notice may encompass the status of other lawsuits in other courts and the substance of papers filed in those actions"); Giraldo v. Kessler, 694 F.3d 161, 163 (2d Cir. 2012) (courts may "take judicial notice of relevant matters of public record.").
- In this opinion, unless otherwise specified, where reference is made to the "Sackler entities" this means Rosebay and Beacon, as well as other Sackler family affiliated trusts and entities relevant to this appeal, including those in Exhibit X to the Settlement Agreement, incorporated into the Plan. (See Dkt. No. 91-3, at App. 1112, App.1041-1069).
- 13 The Arthur Sackler family sold its interest in Purdue to the other two branches of the family prior to the invention of OxyContin and has no involvement in the company or in this bankruptcy.
- 14 HHS Acting Secretary Declares Public Health Emergency to Address National Opioid Crisis, DHHS (Oct. 26, 2017), https://www.hhs.gov/about/news/2017/10/26/hhs-acting-secretary-declares-public-health-emergency-address-national-opioid-crisis.html.

- 15 Drug Overdose: Overview, Centers for Disease Control and Prevention (Mar. 17, 2021), https://www.cdc.gov/drugoverdose/deaths/prescription/overview.html.
- DHHS, "Addressing Prescription Drug Abuse in the United States," available at https://www.cdc.gov/drugoverdose/pdf/ hhs_prescription_drug_abuse_report_09.2013.pdf.
- 17 Opioid Overdose Crisis, National Institute on Drug Abuse (Mar. 11, 2021), https://www.drugabuse.gov/drug-topics/opioids/opioid-overdose-crisis.
- See Hurtado, et al. v. The Purdue Pharma Co., No. 12648/03 (Richmond Cnty., filed 2003); Sara v. The Purdue Pharma Co., No. 13699/03 (Richmond Cnty., filed 2003); Serafin v. Purdue Pharma, L.P., No. 103031/04 (New York Cnty., filed 2004); Washington v. Purdue Pharma L.P., No. 107841/04 (New York Cnty., filed 2004); Machey v. The Purdue Pharma Co., No. 1:04-cv-02098 (S.D.N.Y., filed 2004); Pratt v. The Purdue Pharma Co., No. 1:04-cv-02100 (S.D.N.Y., filed 2004); Wilson v. The Purdue Pharma Co., No. 1:04-cv-02103 (S.D.N.Y., filed 2004); Ruth v. The Purdue Pharma Co., No. 1:04-cv-02101 (S.D.N.Y., filed 2004); Terry v. The Purdue Pharma Co., No. 1:04-cv-02102 (S.D.N.Y., filed 2004); Foister v. Purdue Pharma L.P., No. 6:01-cv-00268 (E.D. Ky., removed 2001); Gevedon v. Purdue Pharma, No. 7:02-cv-00008 (E.D. Ky., removed 2002); Campbell v. Purdue Pharma, L.P., No. 1:02-cv-00163 TCM (ED Mo. removed 2002); Howland et al. v. Purdue Pharma, L.P. et al., No. CV01 07 1651 (Butler Cnty. Ohio, filed 2001); see also In re OxyContin Products Liability Litigation, 268 F.Supp.2d 1380, 1380 (J.P.M.L 2003) (stating 20 actions then pending in five federal districts in South Carolina, Mississippi, Alabama, and Louisiana).
- Settling states were Arizona, Arkansas, California, Connecticut, Idaho, Illinois, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Montana, Nebraska, Nevada, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Vermont, Virginia, Washington, and Wisconsin. This includes all State Appellants except Delaware and Rhode Island.
- 20 Purdue is defined in the Consent Judgment as Purdue Pharma, PPI, The Purdue Frederick Company, and all of their United States affiliates, subsidiaries, predecessors, successors, parents and assigns, who manufacture, sell, distribute and/or promote OxyContin.
- "all ... present, former, or future masters, insurers, principals, agents, assigns, officers, directors, shareholders, owners, employees, attorneys, representatives. subsidiaries, divisions, affiliates, associated companies, holding companies, partnerships, and joint ventures ..." (JX-2225).
- 22 Purdue Frederick Company is an affiliate of Purdue that manufactures and distributes OxyContin. (Dkt. No. 91-4, at App.1268).
- The fine and payments include: approximately \$276.1 million forfeited to the United States; approximately \$160 million paid to federal and state government agencies to resolve liability for false claims made to Medicaid and other government healthcare programs; approximately \$130 million set aside to resolve private civil claims; approximately \$5.3 million paid to the Virginia Attorney General's Medicaid Fraud Control Unit; approximately \$20 million paid to fund the Virginia Prescription Monitoring Program; approximately \$3 million to Federal and State Medicaid programs for improperly calculated Medicaid rebates; approximately \$5 million in monitoring costs; and a \$500,000 maximum statutory fine.
- 24 The Sacklers do not concede the truth of Purdue's admissions.
- The entities were described as those "known and unknown entities" that the Sacklers allegedly "used as vehicles to transfer funds from Purdue directly or indirectly to themselves," including Rosebay and Beacon. *Id.* at ¶¶49-54.
- A California court recently issued a "tentative decision" rejecting the public nuisance theory of liability against Johnson & Johnson and other pharmaceutical companies, including Teva, Allergan, Endo and Janssen. See Tentative Decision, California v. Purdue Pharma, L.P., et al., No. 30-2014-00725287-CU-BT-CXC, Dkt. No. 7939 (Cal. Sup. Ct. Nov. 1, 2021). The same theory of liability was thrown out by the Oklahoma Supreme Court in a case against Johnson & Johnson. See State ex rel. Hunter v. Johnson & Johnson, 499 P.3d 719 (Okla. Sup. Ct. Nov. 9, 2021). However, also last month, an Ohio jury found three major pharmacy chains liable for damages on the theory that their filling of pill mill prescriptions for opioids created a public nuisance. See Ohio jury holds CVS, Walgreens and Walmart liable for opioid crisis, NPR (Nov.

2022 SOUTHEAST BANKRUPTCY WORKSHOP

- 23, 2021), available at https://www.npr.org/2021/11/23/1058539458/a-jury-in-ohio-says-americas-big-pharmacy-chains-are-liable-for-the-opioid-epide.
- 27 Beverly Sackler was not sued in Delaware or Maryland. Mariana Sackler was only sued in California.
- Prior to bankruptcy, the lawsuit brought by North Dakota was litigated to judgment, and that judgment was in favor of Purdue. (See Dkt. No. 91-4, at App.1278).
- Purdue Canada is an IAC. It is not a Debtor in this case. Purdue Canada as defined in the Shareholder Settlement Agreement, means Bard Pharmaceuticals Inc., Elvium Life Sciences GP Inc., Elvium Life Sciences Limited Partnership, Elvium ULC, Purdue Frederick Inc. (Canada), Purdue Pharma (Canada), Purdue Pharma Inc. (Canada), and Purdue Pharma ULC. (JX-1625.0027).
- 30 Provinces plan legal push against Purdue Pharma in wake of U.S. opioid deal, The Globe and Mail (Sept. 3, 2021), https://www.theglobeandmail.com/canada/article-provinces-plan-legal-push-against-purdue-pharma-in-wake-of-us-opioid.
- The absolute amount of these distributions dwarfed distributions for the 1995-2007 period because concerns about the validity of Purdue's OxyContin patent capped its earnings until 2008, when it was definitively held that the patent was valid. (See Dkt. No. 241, at 6). After that, Purdue's earnings soared as did both the amount owed in taxes and the amount that ended up in the Sackler family trusts.
- 32 Mr. Dubel served as the Chairman of the Special Committee of the Board. He was appointed to the Board in July 2019 and chaired the Special Committee investigating the potential claims of Purdue or its estates against the Sacklers. (See Bankr. Dkt. No. 3433, at ¶1).
- 33 See e.g., Purdue Pharma's bankruptcy plan includes special protection for the Sackler family fortune, The Washington Post (Sept. 19, 2019), https://www.washingtonpost.com/business/2019/09/18/purdue-pharmas-bankruptcy-plan-includes-special-protection-sackler-family-fortune; Where did the Sacklers move cash from their opioid maker?, ABC News (Sept. 5, 2019), https://abcnews.go.com/US/wireStory/sacklers-move-cash-opioid-maker-65407504.
- 34 See Official Committee of Unsecured Creditors of Purdue Pharma L.P. and Affiliated Debtors: General Information, KKC, available at http://www.kccllc.net/PurdueCreditors.
- As of October 21, 2021, 628,389 claims have been filed. See Bankruptcy Claim Report, available at https://restructuring.primeclerk.com/purduepharma/Home-DownloadPDF?id1=MTMwMjM2Mw%3D%3D&id2=0.
- NAS monitoring claims are those of legal guardians of children born with neonatal abstinence syndrome due to exposure to opioids in utero. (Dkt. No. 91-4, at App.1404; see Dkt. No. 115-1 at 3).
- The Bankruptcy Court did not define what the "Consenting Ad Hoc Committee" was, but the mediators' March 23, 2021 report lists "the Consenting States and the Ad Hoc Committee" as consisting of the AHC plus the various consenting states listed there notably Texas, Tennessee, and Florida. (See Bankr. Dkt. No. 2548, at 2). The Court assumes this is what is meant by the "Consenting Ad Hoc Committee."
- Occurring contemporaneously with the mediation was a Special Committee's "comprehensive investigation into potential claims that the Debtors may have against the Sackler Families and Sackler Entities," led by attorneys from Davis Polk, who represent the Debtors in the bankruptcy. (Dkt. No. 91-4, at App.1537-1553). Throughout the mediation, the Special Committee was kept apprised of the "offers and counteroffers that had been communicated through the Mediators by the NCSG, on the one hand, and the Sackler Families, on the other hand." (Id. at App.1552).
- 39 At that time, the non-consenting states included Colorado, Connecticut, Delaware, the District of Columbia, Hawaii, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Minnesota, Nevada, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, and Wisconsin.
- 40 The value of the "naming rights" concession is dubious, since institution after institution, both here and abroad, is taking the Sacklers' name off various endowed facilities, including the Louvre and the Metropolitan Museum of Art. See Louvre

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

Removes Sackler Family Name From Its Walls, The N.Y. Times (Jul. 17, 2019), https://www.nytimes.com/2019/07/17/arts/design/sackler-family-louvre.html; Met Museum Removes Sackler Name From Wing Over Opioid Ties, The N.Y. Times (Dec. 9, 2021), https://www.nytimes.com/2021/12/09/arts/design/met-museum-sackler-wing.html

- 41 Many issues addressed by Judge Drain in his comprehensive opinion are not implicated by any of the appeals to this Court, and so will not be addressed in this decision. These include: objections from insurers that the Plan was not insurance neutral; from the U.S. Trustee to the Plan's treatment of certain attorney fees and expenses; to objections by certain prisoners who filed claims but challenged the sufficiency of notice and what they perceived as a compromising of their rights under the Mandatory Victims Restitution Act, 18 U.S.C. § 3663A; objections by certain states to their classification in the same voting class as their political subdivisions; an objection by the State of West Virginia to the allocation plan for states from the NOAT; and objections by certain Pro Se Appellants to the Plan's release of the Sacklers from criminal liability (it does not).
- 42 Judge Drain considered all of the *Iridium* factors, but not in the order in which they are discussed in *Iridium*. I employ Judge Drain's framework in this decision.
- 43 Given Purdue's admissions in connection with its 2020 Plea Agreement, this Court cannot assign much weight to the "oversight" factor.
- 44 It is actually not clear what members of the Sackler family are contributing to the settlement and in what amounts. The record contains some suggestion that the various trusts that are contributing are for the benefit of all members of the family.
- Judge Drain did not explain what he meant by that, except to say that the release would be further narrowed so that it was limited in the manner discussed above. I assume that he meant that the release was limited to claims involving the Debtor's conduct, and claims in which the Debtor's conduct is "a legal cause of the released claim, or a legally relevant factor to the third-party cause of action." *In re Purdue Pharma L.P.*, 2021 WL 4240974, at *45.
- Judge Drain also argued that the best interest test under section 1129(a)(7) requires that the amount that an objecting creditor stands to receive under the plan on account of its claim be at least as much it would receive if the debtor were liquidated under chapter 7. In re Purdue Pharma L.P., 2021 WL 4240974, at *50. Thus, he concluded, the best interest test does not require analysis of the claimant's rights against third parties. Id. He acknowledged that his reading of the statute was at odds with at least two of his colleagues' reading of the same statute. I mention this fact but it has nothing to do with the ultimate decision on this appeal.
- 47 California, Connecticut, Delaware, Maryland, Oregon, Rhode Island, Vermont, and Washington.
- The City of Grande Prairie as Representative for a Class Consisting of All Canadian Municipalities, the Cities of Brantford, Grand Prairie, Lethbridge, and Wetaskiwin; the Peter Ballantyne Cree Nation on behalf of All Canadian First Nations and Metis People and on behalf itself and the Lac La Ronge Indian Band.
- 49 Ronald Bass, Marie Ecke, Andrew Ecke, Richard Ecke, and Ellen Isaacs on Behalf of Patrick Ryan Wroblewski.
- Beyond the above issues, (1) the State Appellants asserts a further issue that the bankruptcy court improperly applied the best interest of creditors test; (2) the Canadian Appellants assert that the Bankruptcy Court does not have personal jurisdiction over their claims, and that the bankruptcy court's approval of the release violated their foreign sovereign immunity and the Foreign Sovereign Immunities Act, 28 U.S.C. § 1602 et seq.; and (3) the U.S. Trustee also asserts that the Bankruptcy Court erred by approving the Debtors' disclosure statement and plan solicitation materials and by authorizing the Debtors to advance funds under Advance Order.
- 51 "Non-core" proceedings are interchangeably referred to as "related to" proceedings.
- The core/non-core distinction is also critically important when assessing the bankruptcy court's subject matter jurisdiction, a topic that will be taken in that section.

2022 SOUTHEAST BANKRUPTCY WORKSHOP

- This court's decision in *In re Kirwan Offices S.à.R.L.*, 594 B.R. 489 (S.D.N.Y. 2018) does not stand for the proposition that *Stern* authorizes a bankruptcy court to release non-core claims because a release is not a final judgment on the merits of the third-party claim. In that case, *Stern* was of no moment because, as this court held and the Second Circuit affirmed, all parties had consented to the bankruptcy court's exercise of jurisdiction. *In re Kirwan Offices S.à.R.L.*, 792 F. App'x 99, 103 (2d Cir. 2019).
- The practical impact of this holding is non-existent, as no one has challenged any of Judge Drain's findings of fact only the conclusions he drew from them and the court has always had the obligation to review those conclusions *de novo*.
- The debtors clarified at oral argument that for the relevant periods of time "like 2017 when the claims were made and those policies got triggered" there are applicable claims-made insurance policies, as well as "over a billion dollars of general liability policies" and other policy language that "creates the risk that all Sackler-owned entities could assert claims under those policies." (Oral Arg. Tr., Nov. 30, 2021, at 125:21-12614).
- In *Kirwan*, the appellant chalked up his failure to raise the issue of statutory authority to his belief that the U.S. Trustee ought to have done so. *In re Kirwan Offices S.à.R.L.*, 592 B.R. at 501. The U.S. Trustee, for perfectly understandable reasons that will be noted when *Kirwan* is discussed below, had no particular interest in using that case as a vehicle to mount such an attack
- The Section 10.7 Shareholder Release extends to every Sackler presently alive, to their unborn progeny, and to various trusts, partnerships, corporations, and enterprises with which they are affiliated or that have been formed for their benefit. Exhibit X to the Settlement Agreement, expressly incorporated into the Plan (see Dkt. No. 91-3, at App. 1112), identifies over 1,000 separate released parties, either by name or by some "identifying" feature, such as "the assets, businesses and entities owned by" the named released parties. (See Dkt. No. 91-3, at App.1041-1069).
- While Judge Drain expressly found that these claims were not derivative (*In re Purdue Pharma L.P.*, 2021 WL 4240974, at *44), he was quite clear that the congruence between these claims and derivative claims against the same individuals was critically important to his conclusion that they could be released.
- 1 can only assume that this argument derives from Congress' mention of the fact that courts dealing with non-asbestos bankruptcies were "reportedly beginning to experiment with similar mechanism."
- In a structured dismissal, the debtor obtains an order that simultaneously dismisses its chapter 11 case and provides for the administration and distribution of its remaining assets.
- The Court is advised that the *Manville I* injunction did not conform in every particular to the rules set out in Section 524(g), and that Section 524(h) was included in the Bankruptcy Code to be sure that the *Manville I* injunction was deemed to be Code-compliant notwithstanding that fact.
- It bears reiterating that *Drexel* was one of those cases to which the Judiciary Committee referred when it said that debtors in other industries were "reportedly experimenting" with non-debtor injunctions in the years prior to the passage of Section 524(g). See supra, note 59.
- 63 It is, of course, for the Second Circuit to make that call not a district court in the Second Circuit.
- 64 In re Dairy Mart was hardly the first time this settled principle had been recognized by the Second Circuit. See, e.g., FDIC v. Colonial Realty Co., 966 F.2d 57, 59 (2d Cir. 1992) ("105(a) limits the bankruptcy courts equitable powers, which 'must and can only be exercised within the confines of the Bankruptcy Code") (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206, 108 S.Ct. 963, 99 L.Ed.2d 169, (1988)).
- I disagree with Appellants that *Metromedia*'s discussion of non-consensual third-party releases is dictum. (*See id.*). The actual holding in the case is that the bankruptcy court failed to make the findings in order to justify approval of such a release. *Metromedia*, 416 F.3d at 143. A discussion of what type of findings would be necessary to approve a non-consensual third-party release was, at least arguably, a necessary predicate to that holding. The court's equitable

In re Purdue Pharma, L.P., 635 B.R. 26 (2021)

- mootness ruling only justified the decision not to remand so that the missing findings could be made. The court did not vacate approval of the releases on equitable mootness grounds, so it was not the actual holding in the case.
- Further to the discussion of *Drexel* the case was cited by a Second Circuit in *Metromedia*, but only for the proposition that a contribution to a debtor's estate from a released third party was one factor that had in the past been relied on by a court to justify a non-debtor release. That is true as a matter of simple fact. As far as this Court can tell, that is about all that can be said to be left of *Drexel*.
- 67 Manville III, 517 F.3d at 66; Manville IV, 600 F. 3d at 152; In re Quigley Co., 676 F.3d 45 (2d Cir. 2012).
- They get the phrase "residual authority" from *United States v. Energy Res. Co.*, 495 U.S. 545, 549, 110 S.Ct. 2139, 109 L.Ed.2d 580 (1990), which I discuss in detail below.
- 69 11 U.S.C. §§ 507(a)(7), 523(a)(1)(A).
- 70 11 U.S.C. § 1129(a)(9)(C).
- 71 The U.S. Trustee has also appealed from the Disclosure Order, asserting that it was inaccurate in certain respects. (Dkt. No. 91, at 10; Dkt. No. 191, at 10). As the Confirmation Order has been vacated without reaching the notice/due process constitutional issues that were raised by the U.S. Trustee, I do not understand that any substantive ruling is needed with respect to the Disclosure Order. Like everything else connected with the Plan, it simply falls by the wayside.

End of Document

© 2022 Thomson Reuters. No claim to original U.S. Government Works.

Faculty

Jessica C. Lauria is a partner in White & Case LLP's Financial Restructuring and Insolvency Practice in New York, where she represents clients in a wide variety of in-court and out-of-court restructuring matters. Her work includes providing advice on complex questions relating to governance in the corporate restructuring context, as well as, among other things, analysis, strategic advice and negotiation of all aspects of corporate restructurings, including debtor-in-possession financing arrangements, cash-collateral usage and exit financing facilities; formulation of legal and financial strategies for negotiating and implementing plans of reorganization; negotiating debt and equity documents for reorganized companies; strategic advice and negotiation of sale documents and pleadings in connection with § 363 and other complex asset sales; strategic planning for debt-restructuring alternatives and chapter 11 filings; preparing debtors for chapter 11 filings; and structuring exit strategies for chapter 11 proceedings. She also has extensive experience representing clients in connection with mass tort chapter 11 proceedings. Ms. Lauria is listed in *The Deal*'s "Top Women in Dealmaking for Restructuring" for 2021, Crain's New York Business "Notable Women in Law" for 2021, The Best Lawyers in America for 2020 and 2021, Global Restructuring Review's 40 under 40 list for 2016, Turnarounds & Workouts' Outstanding Young Restructuring Lawyers for 2015, and Chambers USA for New York Bankruptcy/Restructuring as an "Up and Coming" lawyer. She is admitted to practice in Illinois and New York. Ms. Lauria received her B.A. in political science from the University of Minnesota, Twin Cities and her J.D. from the University of Minnesota Law School.

David J. Molton is a partner at Brown Rudnick LLP in the firm's Litigation & Arbitration and Bankruptcy & Corporate Restructuring Practice Groups and is the chair of its Cross-Border, Mass Tort, and Restructuring Litigation. He focuses his practice on complex financial, commercial and mass tort litigation matters in federal, state and bankruptcy courts in the U.S., and he represents foreign liquidators, official committees of creditors, unofficial ad hoc committees of creditors and interested parties in financial fraud and mass tort-related litigations and bankruptcies in the U.S. and in foreign jurisdictions. Mr. Molton is a Fellow of INSOL International, a worldwide federation of national associations for lawyers, accountants and other professionals who specialize in financial fraud, asset-tracing and recovery and insolvency in domestic and cross-border cases. Previously, he clerked for Hon. J. Edward Lumbard of the U.S. Court of Appeals for the Second Circuit. Earlier in his career, he served as an assistant district attorney in and for the Office of the District Attorney for New York County, where he was assigned to the Special Narcotics Prosecutor for the City of New York under Hon. Sterling Johnson, Jr. As a prosecutor, Mr. Molton supervised joint federal/state law enforcement task force teams and investigations for the New York Drug Enforcement Task Force and the Department of Justice's Organized Crime Drug Enforcement Task Force, and he prosecuted cases involving racketeering enterprises and organized crime narcotics conspiracies and distribution networks, and efforts to locate, seize and effectuate the forfeiture of proceeds and assets connected to those criminal activities both in the U.S. and abroad. Mr. Molton is admitted to practice in New Jersey and California, and before the U.S. Supreme Court; the U.S. Courts of Appeals for the Second, Third and Ninth Circuits; the U.S. District Courts for the Southern, Eastern and Northern Districts of New York, the District of New Jersey, and the Northern Districts of Illinois and California; and the Dubai International Financial Centre Courts. He received his B.A. summa cum laude and Phi Beta

Kappa in 1979 from Brandeis University, and his J.D. *cum laude* in 1982 from New York University School of Law, where he was admitted to the Order of the Coif.

Andrew R. Vara is the U.S. Trustee for Regions 3 and 9 in Cleveland, which encompass 10 field offices in Delaware, New Jersey, Pennsylvania, Ohio and Michigan. He has worked for the U.S. Department of Justice for 29 years, serving as a trial attorney, Assistant U.S. Trustee in Cleveland and Wilmington, Del., and the acting assistant U.S. Trustee in both the Southern District of New York and Western District of Michigan. Following law school, Mr. Vara clerked for Hon. Laurence Howard, Chief Judge for the U.S. Bankruptcy Court in Grand Rapids, Mich. He also is a regular faculty member and lecturer at training seminars held at the National Advocacy Center in Columbia, S.C. Mr. Vara has been a panelist at numerous ABI conferences, including its Annual Spring Meeting, Winter Leadership Conference, Mid-Atlantic Bankruptcy Workshop and Central States Bankruptcy Workshop. He was a member of the ABI's Ethics Task Force and chaired ABI's Ethics and Professional Compensation Committee. Mr. Vara served as a presenter on U.S. and international insolvency law at forums sponsored by the Commercial Law Development Program in Bahrain and the Kingdom of Saudi Arabia. He received his B.A. *magna cum laude* in political science from Duke University and his J.D. with honors from The Ohio State University in May 1991, where he was awarded membership in the Order of the Coif.

Jeffrey R. Waxman is a partner in the Bankruptcy and Creditors' Rights Group of Morris James LLP in Wilmington, Del., and represents debtors, official committees of unsecured creditors, official committees of equity holders, secured creditors, plan administrators, purchasers of assets, and a wide variety of creditor constituencies and interested parties in chapter 11 cases. He also represents chapter 7 trustees and plaintiffs and defendants in bankruptcy-related preference and fraudulent transfer litigation. Prior to entering private practice, Mr. Waxman clerked for Hon. Mary F. Walrath of the U.S. Bankruptcy Court for the District of Delaware, and for Hon. Michael J. Kaplan of the U.S. Bankruptcy Court for the Western District of New York. He is admitted to practice in Delaware and Pennsylvania, and before the U.S. District Courts for the District of Delaware and the Eastern District of Pennsylvania, the U.S. Court of Appeals for the Third Circuit, and the U.S. Supreme Court. Mr. Waxman co-chairs Morris James' Small Businesses and Start-Ups Group, which provides a full range of legal services to assist small business owners to organize and transition their ideas to full-fledged businesses. The practice focuses on addressing issues that are of particular concern to entrepreneurs including initial corporate governance, employment, financing, tax issues and liquidity. He also has been listed as a "Top Lawyer" in Delaware Today for 2015, received ABI's Medal of Excellence in Bankruptcy, and is a member of the Order of the Barristers. Mr. Waxman is a member of the American Bar Association's Business Law Section, ABI (for which he serves on its Southeast Bankruptcy Workshop advisory board), the Delaware Bankruptcy American Inn of Court and the Delaware State Bar Association's Bankruptcy Section (for which he served as past chair). Mr. Waxman received his B.A. from Temple University in 1995 and his J.D. from the University of Pittsburgh School of Law in 1998.