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## 2022 Winter Leadership Conference

# Third-Party Releases: The Lay of the Land After *Purdue*

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## Third Party Releases After *Purdue*





## Get the Terminology Right

Chapter 11 plans may contain many types of protections that are not actually third-party releases:

- Debtor releases of estate claims
- Exculpation clauses
- In rem releases/channeling injunctions
- Consensual third-party releases for separate consideration



## Non-Consensual Third-Party Releases

- Release a creditor's/shareholder's direct personal claims against a non-debtor third party
- Released claims are not estate claims but must be connected to the debtor
- Appellate case law cautions such releases should be rare



## Circuits Are Split:

Sections 105(a) and/or 1123(b)(6) authorize third-party releases:

*In re A.H. Robins Co.*, 880 F.2d 694 (4th Cir. 1988) (105)

*In re Continental Airlines*, 203 F.3d 202 (3d Cir. 2000) (105)

*In re Dow Chemical Corp.*, 280 F.3d 648 (6th Cir. 2002) (both)

*In re Airadigm Communications*, 519 F.3d 640 (7th Cir. 2007) (both)

*In re Seaside Eng'g*, 780 F.3d 1070 (11th Cir. 2015) (105)



## Circuits Are Split:

Section 524(e) prohibits third-party releases:

*In re Western Real Estate*, 922 F.2d 592 (10th Cir. 1991)

*In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995)

*In re Zale Corp.*, 62 F.3d 746 (5th Cir. 1995)



## ***In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021)***

- Interplay of Sections 524 (e) and (g) and Public Law 111 limit third -party releases to asbestos cases and charge Congress with making any expansion of such releases, not the courts
- Supreme Court and Second Circuit precedent does not support Section 105(a) as authority for third-party releases
- Section 105(a) is limited to carrying out provisions of the Code and does not create new substantive rights



## ***In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021)***

- Section 1123(b)(6), which authorizes a plan to contain "any other appropriate provision not inconsistent with the applicable provisions of this title" does not confer any substantive authority and releases were inconsistent with Sections 523 and 524(e)
- Section 1123(b)(5), which authorizes a plan to "provide adequate means for the plan's implementation" does not authorize third-party releases which take property from third parties; "the mere fact that money is being used to fund a plan does not give the bankruptcy court statutory authority to enter an impermissible order in order to obtain that funding."



## ***In re Purdue Pharma, L.P., 635 B.R. 26 (S.D.N.Y. 2021)***

- Authority for third-party releases cannot be inferred from the Code's silence on the subject in light of Section 524(g); the "silence that speaks volumes" is Congress's failure in the past 27 years to authorize third-party releases for cases other than those addressing asbestos liabilities releases
- General provisions like Sections 105(a) and 1123(a)(5) and (b)(6) cannot override specific provision like Section 524(g)
- Bankruptcy Court lacks subject matter jurisdiction to release *in personam* third party claims against a non-debtor



## **Second Circuit Appeal**

### *Purdue:*

- 30 years of Second Circuit precedent authorizes the releases
- Only question under this precedent is whether the releases were important to the success of the plan and the record supported that the plan would have failed without them, making this the "rare" case where such releases should be approved
- The bankruptcy court had constitutional authority to approve the releases because they were "integral to the restructuring of the debtor-creditor relationship"



## Second Circuit Appeal

### *U.S. Trustee:*

- The Code does not authorize the releases and Sections 105 and 1126 only authorize the exercise of authority within the confines of the Code
- Purdue's interpretation of the Code raises serious due process concerns as it takes creditors' property without their consent
- Statutory silence does not equate to statutory authorization
- Only an Article III court may enter a final judgment extinguishing third party claims



## Second Circuit Appeal

### *Amici Professors:*

- Third-Party Releases violate:
  - the Constitution's separation of powers
  - the ban against substantive federal common lawmaking
  - creditors' due process rights
  - creditors' rights to a jury trial and adjudication in an Article III court
- Bankruptcy courts have in rem injunctive powers to protect estate property



## Hypothetical #1:

- Non-profit debtor with limited assets (*i.e.* office equipment, insignificant A/R) but significant insurance policies faces tort liability to hundreds of claimants
- Sponsoring entity with supervisory powers over debtor named as co-insured on debtor purchased insurance policies
- Sponsoring entity along with related parties covered by policies named in pre-petition lawsuits
- Insurance carriers refuse to engage without participation of all insureds, claiming concerns over bad faith claims



## Hypothetical #2:

- Public company debtor with operating business files and sells substantially all of its assets in a Section 363 sale to its lenders
- Pre-bankruptcy shareholders are pursuing securities claims against officers and directors
- Committee settles breach of fiduciary duty claims with D&O carrier on condition that all covered claims, including securities claims, are released in plan



## Exculpations

- Set standard of care for claims held against professionals and other estate fiduciaries
- Typically limited in scope (related to chapter 11 case) and time (post-petition); include carve out for gross negligence and willful misconduct
- Circuit split on who is entitled to protection



## Hypothetical #3:

- Public company debtor with operating business files and sells substantially all of its assets in a Section 363 sale to its lenders
- Pre-bankruptcy shareholders are pursuing securities claims against officers and directors
- Committee settles breach of fiduciary duty claims with D&O carrier on condition that all covered claims, including securities claims, are released in plan



## Hypothetical #3:

*Who gets exculpated?*

- Lender
- Lender's Counsel & FA
- Committee
- Committee's Counsel & FA
- Debtor's Counsel & FA
- Directors and Officers
- Independent Directors



## Gatekeeping Provisions

- require third parties to first seek approval from the bankruptcy court before commencing an action against bankruptcy participants
- Bankruptcy Court makes finding that claims are "colorable"
- seek to stem bad faith litigation that could jeopardize plan's effectiveness
- avoid questions re Bankruptcy Court's subject matter jurisdiction over claims



## Hypothetical #4:

No Enjoined Party may commence or pursue a claim or cause of action of any kind against any Protected Party that arose or arises from or is related to the Chapter 11 Case, the negotiation of the Plan, the administration of the Plan or property to be distributed under the Plan, the wind down of the business of the Debtor or Reorganized Debtor, or the transactions in furtherance of the foregoing without the Bankruptcy Court (i) first determining, after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind, including, but not limited to, negligence, bad faith, criminal misconduct, willful misconduct, fraud, or gross negligence against a Protected Party and (ii) specifically authorizing such Enjoined Party to bring such claim or cause of action against any such Protected Party.



## Hypothetical #4 (continued):

The Bankruptcy Court will have sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable and, only to the extent legally permissible, shall have jurisdiction to adjudicate the underlying colorable claim or cause of action.

# Faculty

**Hon. Barbara J. Houser** is a retired U.S. Bankruptcy Judge for the Northern District of Texas in Dallas, now serving on recall status, and she is ABI's Immediate Past President. She previously was with Locke, Purnell, Boren, Laney & Neely in Dallas and became a shareholder there in 1985. In 1988, she joined Sheinfeld, Maley & Kay, P.C. as the shareholder-in-charge of the Dallas office and remained there until she was sworn in as a U.S. Bankruptcy Judge in 2000. While at Sheinfeld, Judge Houser led the firm's representation of clients in a variety of significant national chapter 11 cases. She lectures and publishes frequently, is a past chairman of the Dallas Bar Association's Committee on Bankruptcy and Corporate Reorganization, is a member of the Dallas, Texas and American Bar Associations, and is a Fellow of the Texas and American Bar Foundations. Judge Houser served as a contributing author to *Collier on Bankruptcy* for many years and taught creditors' rights as a visiting professor at the SMU Dedman School of Law. She was elected a Fellow of the American College of Bankruptcy in 1994, and in 1996, she was elected a conferee of the National Bankruptcy Conference. In 1998, the National Law Journal named Judge Houser as one of the 50 most influential women lawyers in America. After becoming a bankruptcy judge, she joined the National Conference of Bankruptcy Judges and served as its president from 2009-10. Judge Houser has received a variety of awards and honors since taking the bench, the Distinguished Alumni Award for Judicial Service from the SMU Dedman School of Law in February 2011, ABI's Judge William Norton Jr. Judicial Excellence Award in October 2014, and the Distinguished Service Award from the Alliance of Bankruptcy Inns of the American Inns of Court in October 2016. She also received the Distinguished Service Award from the American College of Bankruptcy in October 2021. Judge Houser has served the judiciary in a number of capacities during her 21 years on the bench, including as a member of the Judicial Conference Committee on the Administration of the Bankruptcy System for seven years, as a member of the faculty that the Federal Judicial Center selected to teach new bankruptcy judges for many years, and as a member of the board of directors of the Federal Judicial Center, which is chaired by Chief Justice John Roberts. In June 2017, she was appointed to serve as the leader of a five-federal-judge mediation team tasked with settling all of the issues in dispute in connection with the historic insolvency filings by the Commonwealth of Puerto Rico and certain related instrumentalities under Title III of PROMESA. Judge Houser received her undergraduate degree with high distinction from the University of Nebraska and her J.D. from Southern Methodist University Law School, where she was editor of its law review.

**Tancred Schiavoni** is a partner with O'Melveny & Myers LLP in New York and co-chairs the firm's Insurance Practice, representing insurance and reinsurance companies in a variety of disputes, including bad faith claims and environmental coverage litigation. He has represented carriers in cases in a number of states, including New Jersey, New York and New Hampshire. Mr. Schiavoni also has conducted and assisted in mediations and provided coverage advice to clients to assist them in avoiding disputes without the need for litigation. He participated at trial in the defense of a major environmental coverage action involving multiple parties and claims for coverage exceeding US\$500 million. He also was involved in the trial of another major multiparty coverage dispute involving coverage claims in a dozen states and Canada. Mr. Schiavoni has been recognized as a Local Litigation Star and National Practice Area Star for Insurance by *Benchmark Litigation* (2020-23), ranked by *Chambers USA* in the New York and Nationwide "Insurance: Dispute Resolution: Insurer" cate-

gories (2012, 2014-22), listed in *The Legal 500 US* as a Leading Lawyer (2013-19) and Hall of Fame (2018, 2020-22) for Insurance, named National Litigation Star in *Benchmark Litigation: The Definitive Guide to America's Leading Litigation Firms and Attorneys* (2013), and named Client Choice 2013 in the New York Insurance & Reinsurance category by *International Law Office* and *Lexology*. In addition, he is rated AV-Preeminent by Martindale-Hubbell and received *Law360's* 2012 MVP award in Insurance honoring achievements in major litigation that have set a new standard for accomplishment. Mr. Schiavoni is admitted to practice before the U.S. District Courts for the District of Connecticut and the Eastern, Northern and Southern Districts of New York; the U.S. Courts of Appeals for the Second, Third, Ninth and Federal Circuits, and the U.S. Supreme Court. He received his B.S. in 1984 and his J.D. in 1988 from Georgetown University, where he was a member of the *Georgetown Journal of Legal Ethics*.

**Catherine L. Steege** is a partner with Jenner & Block LLP in Chicago and co-chairs the firm's Bankruptcy and Restructuring practice group. She is a Fellow of the American College of Bankruptcy and a member of the National Bankruptcy Conference, and she has been a member of the panel of trustees for the Northern District of Illinois since 1987. In addition to a traditional bankruptcy practice, Ms. Steege has represented numerous parties in complex bankruptcy litigation matters, including her representation of defendants in the *Tribune* fraudulent-conveyance litigation and the *Sentinel Management Group* litigation trustee, the *Magnatrx* litigation trust, the *NKK* litigation trust and the trustees of Emerald Casino Inc. and Consolidated Industries Corp. She has an active appellate practice and argued in the U.S. Supreme Court on behalf of Wellness International Network in *Wellness International Network v. Sharif*. She also represented the petitioner in *Law v. Siegel* and the respondent in *City of Chicago v. Fulton*. In addition, she represented the examiner in the *Lehman Brothers* chapter 11 case and authored the sections of the Lehman Brothers Examiner's Report that considered potential avoidance actions against various financial institutions. Ms. Steege received her J.D. in 1982 from DePaul University.

**Lydia R. Webb** is a partner with Gray Reed & McGraw LLP in Dallas, where she focuses her practice on representing and advising debtors, creditors, committees and post-confirmation trustees in bankruptcy cases and other insolvency or restructuring scenarios. She has guided clients to successful results in complex cases before courts throughout Texas and many other states, including Oklahoma, Delaware and New York. Ms. Webb's cases span the oil and gas, health care, retail, manufacturing and restaurant businesses. She has been listed in *The Best Lawyers in America* in the fields of Bankruptcy and Creditor Debtor Rights/Insolvency and Reorganization Law since 2021 and in Bankruptcy Litigation for 2022-23, was selected to participate in the National Conference of Bankruptcy Judges Next Generation program in 2019, and has been named a "Rising Star" by *Texas Super Lawyers* since 2018. Ms. Webb is an ABI member and is social chair of the DFW Association of Young Bankruptcy Lawyers. She is also a member of the Dallas Bar Association's Bankruptcy Section, The Hon. John C. Ford American Inn of Court and the International Women's Insolvency & Restructuring Confederation. Ms. Webb was honored in 2021 as one of ABI's "40 Under 40." She received her B.B.A. *cum laude* in finance and economics from Baylor University in 2009 and her J.D. *cum laude* from Baylor University School of Law in 2012.