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Bankruptcy Conference

# Third-Party Releases


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CONCURRENT SESSION

2023

# Are Coerced Releases of Non-Title 11 Debtors in Bankruptcy Code Chapter 11 Cases Allowed by The Constitution and the Bankruptcy Code?[1]

By Martin J. Bienenstock[2]

## 1. Synopsis

Chapter 11 reorganization plans allocate the reorganized debtor's value among its creditors and shareholders. When the reorganized debtor needs more capital to survive, the main shareholders sometimes provide it on the condition the court compel all the debtor's creditors and other shareholders to release them from claims related to the debtor ("coerced releases"). For instance, some creditors may contend the main shareholders injured them by defrauding them into extending credit to the debtor. This article analyzes whether federal courts can deprive the debtor's dissenting creditors and minority shareholders of their individual claims against the debtor's main shareholders without violating the Bankruptcy Code and the Constitution.

Determining the legality of coerced releases is facilitated by identifying each right they cause the creditors and shareholders to lose. Exposing the lost rights (the "Lost Rights") highlights the constitutional and statutory rights the coerced releases implicate. After determining which rights are violated, this article considers whether the Constitution's grant of bankruptcy power to Congress to enact uniform bankruptcy laws legalizes such violations, and shows it does not.

Coerced releases violate the following constitutional rights:

1. Violation of Fifth Amendment Substantive Due Process. The Fifth Amendment provides entities suffering takings of their property for public purposes are entitled to just compensation. As compared to eminent domain proceedings, the coerced releases have been ordered without allowing the entities whose claims are taken to prove the values of their individual claims and without proof of the value they receive, let alone proof it amounts to just compensation.

2. Deprivation of Fundamental Rights. One of the unenumerated, fundamental rights protected from denial and disparagement by its exclusion from the Bill of Rights and repeatedly recognized by the Supreme Court is the right to sue because liberty and property rights are meaningless if their violations cannot be remedied in court. Coerced releases eliminate the creditors' and shareholders' rights to sue the shareholders receiving the coerced releases. By contrast, if the

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shareholders receiving the coerced releases filed their own bankruptcy petitions, each creditor and shareholder whose claim is released could file and prove its claim against the shareholders to enable it to acquire its fair share of the shareholders' estates.

3. Violation of Fifth Amendment Procedural Due Process. The constitutionality of bankruptcy law depends on a fair distribution of the debtor's assets to the stakeholders suffering discharge of their claims. Shareholders receiving coerced releases, however, are left with assets for themselves and to pay their personal creditors in full, while they pay an undetermined fraction of the discharged claims. That distribution scheme has no attributes of fairness compared to the distribution schemes in the Bankruptcy Code.

4. Violation of Article III Judicial Power. Coerced releases are issued without allowing the creditors and shareholders suffering them to sue and quantify and enforce their claims against the released shareholders. Withdrawal from Article III judicial cognizance of the creditors' and shareholders' tort and contract claims for money damages violates the Article III judicial power.

5. Violation of Separation of Powers Principle. If the Bankruptcy Code authorizes courts to deprive creditors and shareholders of their rights to sue the released shareholders in exchange for what the released shareholders contribute to the reorganization, Congress violated the separation of powers principle by authorizing the judicial branch to impose a remedy without a trial determining the released claims. And it did so without providing guardrails, thereby either unconstitutionally inviting the creation of federal common law, delegating its legislative power, or violating the major question and vagueness doctrines.

The bankruptcy power neither authorizes nor condones any of the foregoing violations. The Supreme Court maintains the bankruptcy power may not override fundamental rights and routinely holds bankruptcy is subject to the Constitution. There are no Supreme Court opinions allowing deprivation of fundamental rights in bankruptcy cases.

The Bankruptcy Code, by limiting chapter 11 plans to provisions consistent with title 11, does not authorize coerced releases, except in asbestos cases. The releases of non-debtors have been inconsistent with the Bankruptcy Code's disclosure requirements, best interest test, criteria for discharge, and distribution scheme. Thus, as a statutory matter, coerced releases are not authorized by the Bankruptcy Code, except in asbestos cases where they are statutorily authorized, but unconstitutional for all the foregoing reasons.

Are Coerced Releases of Non-Title 11 Debtors in Bankruptcy Code Chapter 11 Cases Allowed by The Constitution and the Bankruptcy Code?

Two Recent Opinions[3] Discussing Coerced Releases

In *Millennium,* the bankruptcy court had confirmed a chapter 11 plan providing for extinguishment of the Title 11[4] debtor's lenders' claims against the debtor's primary shareholders (who are also non-Title 11 debtors) over the objection of one of the lenders.[5] The other co-lenders holding 93% of the lenders' claims had negotiated and accepted the plan to avoid "corporate destruction" of the debtor.[6] Specifically, in exchange for a $325 million contribution to the reorganized debtor by the debtor's primary equity holders, and a transfer of their equity interests to the debtor's lenders, which contribution would enable the reorganized debtor to continue the debtor's business by satisfying a settlement obligation to the United States Department of Justice and avoiding the loss of its Medicare billing privileges without which it could not survive, the primary equity holders would be released from the debtor's lender's RICO and fraud action,[7] and would be released by the debtor's estate from exposure for a $1.3 billion special dividend made to the non-debtor equity holders by the debtor while it was being investigated by the U.S. Department of Justice.[8]

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[3] *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019) ("*Millennium*"), and *In re Purdue Pharma, L.P.,* 635 B.R. 26 (S.D.N.Y. 2021) ("*Purdue Pharma*"), vacating, "Modified Bench Ruling on Request for Confirmation of Eleventh Amended Joint Chapter 11 Plan," in *In re Purdue Pharma L.P.*, *In re Purdue Pharma*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021) (RDD, B.J.), at p. 104 (retrieved at: https://restructuring.primeclerk.com/purduepharma/Home-DocketInfo).
[4] 11 U.S.C. §§ 101 et seq. is the Bankruptcy Code.
[5] *Millennium* at 130-132.
[6] *Millennium* at 132.
[7] *Millennium* at 130, 132 n. 4.
[8] The district court's opinion provides:

> "…In exchange for the $325 million contribution, the proposed Plan provided the Non-Debtor Equity Holders with full releases and discharges of any and all claims against them and related parties - including any claims brought directly by non-Debtor lenders such as Appellants - and including claims relating to the $1.3 billion special dividend that had been paid to the Non-Debtor Equity Holders while the Debtors were in the midst of the DOJ Investigation…."

In the objecting lender'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…"[9]

*Millennium* concluded the non-Article III bankruptcy court could order the coerced release because it was "integral to the restructuring,"[10] which was *Millennium's* mode of communicating it was within the bankruptcy power. *Millennium* did not consider any of the foregoing constitutional issues, most likely because the litigants did not raise them.

In *Purdue Pharma*, the bankruptcy court confirmed the chapter 11 plan which granted the debtor's shareholders and family contributing $4.325 billion to fund the plan (a) a coerced release from non-consenting creditors' claims against the owners and their family to the extent Purdue Pharma's conduct was in material part a legal element of the released claims, and (b) a consensual release of the estate's potential claims arising out of transfers from Purdue Pharma to the owners' family of at least $10.43 billion cash and other non-cash transfers.[11] While Purdue Pharma successfully sold oxycontin to generate billions, at the end of the day, states, cities, individuals, and others contended the company was responsible for creating addictions at their expense.[12] Eight states, many Canadian municipalities and tribes, and individuals appealed the confirmation order because it eliminated their claims against the Sackler family and their affiliates who owned Purdue Pharma, which claims were particularized or direct claims — including claims predicated on fraud, misrepresentation, and willful misconduct under various state consumer protection statutes.[13] The United States District Court reversed, ruling "the Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express 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

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*Opt-Out Lenders v. Millennium Lab Holdings II, LLC (In re Millennium Lab Holdings II, LLC)*, 591 B.R. 559, 564 n. 10 (D.Del. 2018).
[9] *Millennium* at 132.
[10] *Millennium* at 140.
[11] *Purdue Pharma at 36*; "Disclosure Statement for Fifth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors, at pp. 144-146 (retrieved at: https://restructuring.primeclerk.com/purduepharma/Home-DocketInfo?DocAttribute=4218&DocAttrName=PlanDisclosureStatement&MenuID=9013#).
[12] *Purdue Pharma* at 35-36.
[13] *Purdue Pharma* at 36.

court sitting in bankruptcy."[14] The court thus vacated the confirmation order on statutory grounds and observed it was therefore not reaching the constitutional issues.[15]

The bankruptcy courts presiding over the Millennium and Purdue Pharma chapter 11 cases each implicitly assumed the Bankruptcy Code authorized them to order coerced releases and reasoned they could constitutionally do so as non-Article III judges. The district court in *Purdue Pharma* reasoned the issue of whether a non-Article III court could order constitutionally a coerced release meant little in the scheme of things and the real issue was whether the Bankruptcy Code authorizes any court to do so.[16]

Notably, neither *Millennium* nor *Purdue Pharma* discuss the constitutional issues implicated by coerced releases except for whether non-Article III judges can order them or an Article III district judge is required to do so.[17]

Coerced Releases Violate the Fifth Amendment Just Compensation Requirement

The Supreme Court consistently rules the bankruptcy power is subject to the Fifth Amendment's takings clause[18] in cases in which the bankruptcy statute authorizes

[14] *In re Purdue Pharma, L.P.,* 635 B.R. 26, (S.D.N.Y. 2021). Another district court rejected coerced releases after determining the bankruptcy court lacked subject matter jurisdiction over many of the released claims because they did not relate to the bankruptcy, and lacked constitutional authority to determine them. *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 636 B.R. 641, 669-670 (E.D. Va. 2022).
[15] *Purdue Pharma* at 38.
[16] *Purdue Pharma* at 37.
[17] I attribute this article's identification of the Lost Rights and issues to my chemistry lab teacher in tenth grade at Horace Mann School. In the first class, Dr. Albert J. Kroner handed a short candle to each student and instructed us to write lists of all possible observations. Most of us wrote ten to twenty observations. Dr. Kroner showed us thirty six.
[18] U.S. Const. amend. V. ("nor shall private property be taken for public use, without just compensation").

takings of property interests after[19] the bankruptcy case commences.[20] There is no historical exception to that rule applicable to the claims taken in the context of coerced releases.[21] As Justice Brandeis ruled: "The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contracts."[22]

Inside and outside bankruptcy, the taking of private property for public use invokes the Fifth Amendment's last command: "nor shall private property be taken for

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[19] There is a split of authority as to whether the Fifth Amendment compels full payment to creditors holding prepetition takings claims. Compare *Cobb v. City of Stockton (In re City of Stockton)*, 909 F.3d 1256, 1268 (9th Cir. 2018) (rejects argument that takings claim "has protected status because it was originally founded as a constitutional claim") and *Poinsett Lumber Mfg. v. Drainage Dist. No. 7*, 119 F.2d 270, 272–73 (8th Cir. 1941) (just-compensation claim not "invested with a constitutional sanctity beyond other forms of liability" that limits its adjustment) with *Fin. Oversight & Mgmt. Bd. v. Cooperativa de Ahorro (In re Fin. Oversight & Mgmt. Bd.)*, 41 F.4th 29, 41 (1st Cir. 2022) ("we move on to assessing whether the Fifth Amendment precludes the impairment or discharge of prepetition claims for just compensation in Title III bankruptcy. For the following reasons, we conclude that it does."), *cert denied*, 143 S. Ct. 774 (2023).

[20] *See, e.g., United States v. Sec. Indus. Bank*, 459 U.S. 70, 75 (1982); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935). *Reg'l Rail Reorganization Act Cases*, 419 U.S. 109, 162 (1974).

[21] The one historical exception unrelated to coerced releases is for voidable preferences. Normally, taking from a creditor money it received validly in payment of a lawful debt, would be a clear taking of the creditor's property for the public purpose of an equitable distribution, entitling it to just compensation under the Fifth Amendment. But, the debtor's estate's payment of just compensation for the disgorgement of a voidable preference to the estate would undo the creditor's disgorgement and block its redistribution to all creditors to carry out the equity policy to prevent some lucky creditors from being paid in full while others absorb all the losses. Before the Constitution was ratified the bankruptcy power was known to compel creditors to disgorge moneys the debtor had paid them shortly before bankruptcy, without any requirement that creditors be paid just compensation for the disgorged property. *See Schoenthal v. Irving Trust Co., 287 U.S. 92, 94 (1932)*. Thus, it is unsurprising the Supreme Court has signaled the bankruptcy power's claw back of voidable preferences is not subject to the Fifth Amendment's just compensation requirement: "If the argument is that Congress has no power to alter property rights, because the regulation of rights in property is a matter reserved to the States, it is futile. Bankruptcy proceedings constantly modify and affect the property rights established by state law. A familiar instance is the invalidation of transfers working a preference, though valid under state law when made." *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 517 (1938). .

[22] *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935); *Blanchette v. Connecticut General Ins. Corporations*, 419 U.S. 102, 162 (1974) (dissent of Douglas, J).

public use, without just compensation."[23] As the Supreme Court has observed, "nearly all state governments provide just compensation remedies to property owners who have suffered a taking…"[24] Those remedies allow each property owner to prove the value of its taken property, and require the government to pay just compensation. But, in the instance of coerced releases, the creditors and shareholders whose claims against the main shareholders are involuntarily released, have been allowed to prove neither the validity and size of their claims, nor how much they could collect directly from the released shareholders. Moreover, neither the chapter 11 debtor nor the released shareholders have been required to prove the value the released shareholders transferred into the reorganized debtor would provide other creditors and shareholders just compensation for the claims against the released shareholders they were forced to release. In the context of coerced releases, the operation of the government's bankruptcy law takes the creditors' claims against the shareholders and uses them to carry out the law's public purposes of fresh start, rehabilitation, and reorganization by releasing them in exchange for the shareholders' transfers of assets into the restructuring. The creditors receive no just compensation directly from the released parties. Instead, they theoretically receive incremental value indirectly through the released parties' transfers to the reorganized debtor that distributes its stock and debt or other consideration to its stakeholders.

No effort was made in *Millennium* or *Purdue Pharma* to determine the value of the released claims or whether the incremental value received by each entity suffering a taking of its claims equaled just compensation. While the courts approving coerced releases generally reason the coerced releases produce a result in the aggregate for creditors and shareholders superior to allowing each creditor and shareholder to sue the released shareholders, the evidentiary records have included neither evidence approximating the amounts of the valid released claims nor evidence of the shareholders' financial condition and ability to pay. Indeed, the courts' reasoning is more hope than fact given the courts do not know what the creditors could have collected from the shareholders. Thus, the takings are clear, but there is only hope and no showing the compensation paid to creditors matches the value taken from them.

In *Millennium* and *Purdue Pharma*, there is no evidence the released shareholders paid anything to benefit the creditors losing their claims, because in each case, the debtor's estate's claims against the released shareholders exceeded the amount the released shareholders paid to fund the reorganization plan. Therefore, if the debtors' estates' claims against the released shareholders were valid, the shareholders' funding of the reorganization plans did not even satisfy the shareholders' liabilities to the estates, let alone produce additional value in exchange for the released creditors' claims. Professor Adam J. Levitin explains that in the Purdue Pharma case, the coerced releases of the Sackler family were ensured by including them in a chapter

[23] U.S. Const. amend. V.

[24] *Knick v. Twp. of Scott*, 139 S. Ct. 2162, 2176 (2019).

11 plan which included a settlement with the United States Department of Justice under which the department's civil and criminal forfeiture powers would consume all Purdue Pharma's value unless it emerged from chapter 11 as an ongoing public benefit company.[25]

Lack of disclosure of the shareholder's assets and how all its creditors are being treated also runs afoul of Supreme Court rulings in limited fund, non-optout class action settlements under Rule 23 of the Federal Rules of Civil Procedure. Some companies confronted with thousands of tort claims have attempted to resolve them with class action settlements in which they receive the equivalent of a bankruptcy discharge. In exchange for the distributions a company makes, all its tort claimants are barred from attempting to sue for more. The Supreme Court overturned such a settlement due to lack of proof the fund was limited and lack of "assurance that claimants are receiving the maximum fund, not a potentially significant fraction less."[26] In the cases of *Millennium and Purdue Pharma*, there were no assurances about the shareholders' assets, whether they constituted a limited fund, and whether they would be equitably distributed.

<u>Coerced Releases Violate Fifth Amendment Procedural Due Process</u>

No legal training is needed to discern unfairness if a billionaire runs up a credit card tab of $100,000 and is allowed to discharge the debt without paying it while keeping his or her fortune and paying in full other creditors. Our bankruptcy laws have never allowed discharges unless creditors receive the value of the debtor-estate's assets and they share the value on a fair basis. Unsurprisingly, this common sense has constitutional underpinning. The constitution requires every debtor's assets to be distributed fairly which generally means all creditors' similar claims must be treated relatively the same and, absent creditor consent, the debtor cannot retain assets while its creditors suffer losses.

Coerced releases provide the major shareholders a release of claims without any disclosure of the asset value the shareholders retain for themselves and the asset value they pay their personal creditors who are not creditors of the Title 11 debtor. Presumably, the shareholders pay their personal creditors in full because the whole drill is to enable them to avoid their own bankruptcies. In *Millennium* and *Purdue Pharma*, the economics of the coerced releases were further clouded by two facts. First, there was no determination of which claims against the shareholders were valid. Therefore, some invalid claims received value and the creditors and shareholders holding valid claims indirectly received value from the released shareholders in undetermined fractions of the valid claims. Second, in exchange for the shareholders' lump sum

[25] Levitin, Adam J., Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances (March 23, 2022), Texas Law Review, Vol. 100 at pp. 136-139, Available at SSRN: https://ssrn.com/abstract=3851339 or http://dx.doi.org/10.2139/ssrn.3851339.
[26] *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 863 (1999).

contributions to the reorganized debtors, the shareholders not only received coerced releases from the creditors and other shareholders, but also voluntary releases from the debtor's estate. In *Millennium* the shareholders were potentially liable to return a $1.3 billion fraudulent transfer claim for a special dividend, and in *Purdue Pharma* they were potentially liable to return over $10.43 billion they took from Purdue Pharma in prior years.[27] Thus, when the courts ordered coerced releases in *Millennium* and Purdue Pharma, the courts did not know how much was really being paid for them as compared to the estate claims.[28] The shareholders paid the estates much less than the estates' claims against them. The distribution of the shareholders' assets to the reorganized debtors, to the shareholders' personal creditors, and to themselves implicate the due process and just compensation clauses of the Fifth Amendment.[29]

The Fifth Amendment's due process clause (no person shall "be deprived of life, liberty, or property, without due process of law") requires that when the debtor receives a discharge, the debtor's assets must be distributed in a manner "consonant with a fair, reasonable, and equitable distribution of those assets."[30] The bankruptcy power allows courts to confirm chapter 11 plans distributing value in a manner rejected by classes of creditors and shareholders. But, the bankruptcy power also requires that "the creditor gets all the value of his lien and his share of any free assets."[31] To satisfy the fair, reasonable, and equitable distribution requirement, the debtors' assets and liabilities must be known. When they are unknown and creditors cannot prove the claims they make, due process is violated.[32]

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[27] *See* Notes 8 and 11, *supra*.
[28] In respect of Purdue Pharma, *see* Levitin, Adam J., Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances (March 23, 2022), Texas Law Review, Vol. 100 at p. 139, Available at SSRN: https://ssrn.com/abstract=3851339 or http://dx.doi.org/10.2139/ssrn.3851339.
[29] U.S. Const. amend. V.
[30] *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 452 (1937). *accord ACC Bondholder Group v. Adelphia Communications Corp. (In re Adelphia Communications Corp.)*, 361 B.R. 337, 358n. 98 (S.D.N.Y. 2007) (citing *Kuehner*). Fair distribution has also been a hallmark of bankruptcy legislation. *Stellwagen v. Clum*, 245 U.S. 605, 617 (1918) ("The federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equally among his creditors, but as a main purpose of the act, intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors.").
[31] *Reconstruction Fin. Corp. v. Denver & R. G. W. R. Co.*, 328 U.S. 495, 533 (1946).
[32]

> 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

In *Millennium* and *Purdue Pharma*, the shareholders' contributions to the reorganized debtors indirectly repaid an unknown fraction of the creditors' claims against them eliminated by the coerced releases, while the shareholders were left with assets for themselves and their personal creditors. Paying fractionally the shareholders' creditors who were also the Title 11 debtor's creditors while paying the shareholders' personal creditors in full and retaining value for themselves would violate the distribution schemes in both chapters 7 and 11 of the Bankruptcy Code which generally provide for equal treatment of similar claims and payment of creditors before owners. Put differently, it is patent the shareholders' assets were not distributed in a fair, reasonable, and equitable manner allowed by United States bankruptcy statutes since 1800.[33]

Coerced Releases Violate Constitutionally Protected Unenumerated, Fundamental Right to Sue

Coerced releases deprive creditors and shareholders losing their claims against the major shareholders of their day in court. Is Congress empowered to deprive persons and entities of their rights to sue shareholders and to enforce any judgments against the shareholders' assets? Congress is largely empowered by Article I, Section 8 of the Constitution. Nothing there grants Congress such a power, unless it is tucked inside the bankruptcy power, which it cannot be for reasons explained below. Conversely, do the creditors and shareholders have rights not to be divested of their day in court?

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> 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.

*Patterson v. Mahwah Bergen Retail Grp., Inc.*, 636 B.R. 641, 655 (E.D. Va. 2022).

[33] Bankruptcy Act of 1800, 2 Stat. 19, c. 19; Bankruptcy Act of 1841, 5 Stat. 440, c. 9; Bankruptcy Act of 1867, 14 Stat. 517, c. 176; Bankruptcy Act of 1898, 11 U.S.C. §§ 1 et seq.; Bankruptcy Code, 11 U.S.C. §§ 101 et seq.

The Ninth Amendment to the U.S. Constitution provides: "The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people." Thus, the question becomes whether the creditors' and shareholders' right to sue is an unenumerated right the people did not in the Constitution render subject to the federal government's power. Here, the bankruptcy power plays a role. It is uncontested that federal bankruptcy courts can temporarily stay legal actions between non-debtor third parties when the litigation would impair the reorganization effort.[34] But the question here inquires one step further. Is the federal government empowered to deprive non-Title 11 debtors of their day in court permanently, or is the right to sue an unenumerated right reserved to the people. It is the latter.

The right to use the federal courts to protect a litigant's interest is an unenumerated right reserved to the people who are citizens of the United States.[35] Intuitively, this makes sense because no right, whether a property right or liberty right, has meaning if it cannot be judicially enforced. Likewise, the Constitution's Privileges and Immunity clause[36] expressly grants citizens of every state the privileges and immunities of citizens of the other states, which includes the right to sue in each state's courts.

The Supreme Court made clear in *Crandall v. Nevada*[37] and the *Slaughter-House Cases*[38] that "every citizen of the United States…is entitled to free access…to its judicial tribunals…in every State in the Union."[39] Similarly, the Supreme Court has made clear United States citizens have fundamental rights to sue in each state's courts.

In 1823, in response to a claim made under the Privileges and Immunity clause, the circuit court in *Corfield v. Coryell* ruled the privileges and immunities of citizens in all states were "fundamental, which belong, of right, to the citizens of all free

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[34] *See* footnote 51, *infra*.

[35] W. Murphy, J. Fleming, & W. Harris, *American Constitutional Interpretation*, 1083-1084 (1986) (cited in R.E. Barnett, "Introduction: James Madison's Ninth Amendment," at p. 38, published in R.E. Barnett (editor), *The Rights Retained by the People: the history and meaning of the Ninth Amendment* (George Mason University Press 1989).

[36] U.S. Const., Art. IV, § 2, cl 1 ("The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.").

[37] *Crandall v. Nevada*, 73 U.S. 35 (1868) (affirmed overturning of state statute taxing all citizens using vehicles for hire to leave the state on ground it interfered with federal constitutional right of citizens to pass through each state).

[38] *Slaughter-House Cases*, 83 U.S. 36, 79 (1873) (upheld state statute limiting slaughtering to one area and granting slaughtering rights to one company on ground state's police power and nothing more was at issue).

[39] *Crandall v. Nevada*, 73 U.S. 35, 48 (1868) (quoting unopposed *dicta* from Chief Justice Taney's dissent in the *Passenger Cases*, 48 U.S. 283, 492 (1849) (state tax on passengers from foreign ports overturned as unconstitutional state tax on foreign commerce).

governments."[40] Alongside the right of *habeas corpus*, the circuit court identified as a fundamental right protected by the Privileges and Immunity clause, the right "to institute and maintain actions of any kind in the courts of the state…"[41] The right to sue and defend is fundamental because it is the alternative to force and lies at the foundation of orderly government.[42] The Supreme Court has cited *Corfield* with approval and articulated and reaffirmed this fundamental principle several times,[43] and confirmed these fundamental rights are protected by the Constitution.[44] Fundamental rights and liberties are "deeply rooted in this Nation's history and tradition."[45] The United States has a "'deep-rooted historic tradition that everyone should have his own day in court.'"[46] The Supreme Court has ruled the right to enjoy property without unlawful deprivation is a personal right no less than liberty rights such as the rights to speak and travel.[47] As a practical matter, no property or other legal right has substance if its owner cannot enforce it in court or with legal self-help. The Supreme Court concludes personal rights to liberty and personal rights in property have no meaning without each other.[48]

This article would end here if Congress has no power to intrude on the people's fundamental rights, including the right to sue, protected by the Constitution. But, it does. Chief Justice John Marshall, the fourth chief justice of the United States Supreme

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[40] *See Corfield v. Coryell*, 6 F. Cas.546, 551-552 (Cir E.D. Pa. 1823); *Ward v. Md*., 79 U.S. 418, 430 (1871), cites with approval Professor Thomas Cooley's treatise, Cooley, Thomas M. A Treatise on the Constitutional Limitations Which Rest upon the Legislative Power of the States of the American Union. 2nd ed. Boston: Little, Brown & Company, 1871 at 16 n.3, which cites *Corfield* for the proposition in the text. Professor Cooley explains the Privileges and Immunities clause prevents "discriminations by the several States against the citizens and public authority and proceedings of other States." *Id* at 15.

[41] *Corfield v. Coryell*, 6 F. Cas.546, 551-552 (Cir E.D. Pa. 1823). The Supreme Court cites these pages of *Corfield* as "describing unenumerated rights under the Privileges and Immunities Clause, Art. IV, §2, as those 'fundamental' rights 'which have, at all times, been enjoyed by the citizens of the several states.'" *Dobbs v. Jackson Women's Health Organization*, 597 U.S. ___ (June 24, 2022) (Slip Op. at 15 n. 22); *see Slaughter-House Cases*, 83 U.S. 36, 75-76 (1873) (refers to *Corfield* as leading case on Privileges and Immunities issue).

[42] *Chambers v. Baltimore & O.R. Co.*, 207 U.S. 142, 148 (1907).

[43] *See, e.g.*, *Howlett v. Rose*, 496 U.S. 356, 382 n. 26 (1990)(quoting *McKnett v. St. Louis & San Francisco R. Co., 292 U.S. 230, 232 (1934))*; *Canadian N.R. Co. v. Eggen*, 252 U.S. 553, 560 (1920).

[44] *Jones v. Helms*, 452 U.S. 412, 418-419 (1981).

[45] *Wash. v. Glucksberg*, 521 U.S. 702, 721 (1997) (quoting *Moore v. East Cleveland*, 431 U.S. 494, 503 (1977)).

[46] *Martin v. Wilks*, 490 U.S. 755, 762 (1989) (quoting 18 C. Wright, A. Miller, & E. Cooper, Federal Practice and Procedure § 4449, p. 417 (1981)).

[47] *Lynch v. Household Finance Corp.,* 405 U.S. 538, 552 (1972).

[48] *Lynch v. Household Finance Corp.,* 405 U.S. 538, 552 (1972).

Court, ruled Congress can impact fundamental rights when acting pursuant to a power expressly given for national purposes, or a power clearly incidental[49] to some power expressly given.[50] Indeed, it is virtually unchallenged that bankruptcy courts can *temporarily* enjoin creditors and shareholders from suing third parties needed to effectuate a reorganization.[51] Thus, the question becomes whether the bankruptcy power[52] or a power incidental to it includes the power to deprive persons *permanently* of their fundamental right to their day in court.

The Bankruptcy Power[53] Does Not Include the Power to Impose Coerced Releases
Because They Deprive Litigants of Fundamental Rights

Consistent with Article III, Section 2 of the Constitution providing the judicial power of the United States only extends to actual cases and controversies and not to

[49] U.S. Const. Article I, Section 8, Cl. 18 (Congress has the power "To make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this Constitution in the government of the United States, or in any department or officer thereof.").
[50] *Gibbons v. Ogden*, 22 U.S. 1, 203-204 (1824); *Sturges v. Crowninshield*, 17 U.S. 122, 193 (1819) ("…When the American people created a national legislature, with certain enumerated powers, it was neither necessary nor proper to define the powers retained by the States. These powers proceed, not from the people of America, but from the people of the several States; and remain, after the adoption of the constitution, what they were before, except so far as they may be abridged by that instrument.").
[51] *See, e.g.*, *Caesars Entm't Operating Co. v. BOKF, N.A. (In re Caesars Entm't Operating Co.)*, 808 F.3d 1186 (7th Cir. 2015); *Solidus Networks, Inc. v. Excel Innovations, Inc. (In re Excel Innovations, Inc.)*, 502 F.3d 1086, 1094-1095 (9th Cir. 2007); *Feld v. Zale Corp. (In re Zale Corp.),* 62 F.3d 746, 761 (5th Cir. 1995); *In re Western Real Estate Fund, Inc.,* 922 F.2d 592, 601-02 (9th Cir. 1990);
[52] Article I, Section 8, Clause 4 of the United States Constitution is the bankruptcy power and provides "The Congress shall have Power…To establish…uniform Laws on the subject of Bankruptcies throughout the United States…"
[53] Article I, Section 8, Clause 4 of the United States Constitution authorizes Congress to establish "uniform laws on the subject of Bankruptcies throughout the United States."

advisory opinions,[54] the Supreme Court has articulated neither every component of the bankruptcy power granted to Congress nor every limitation on the bankruptcy power.[55]

The Supreme Court has consistently ruled fundamental rights are protected in bankruptcy. It has ruled "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law…"[56] The Supreme Court has explained that while English law does not generally constrain the Constitution, its protections of fundamental rights continue to protect the fundamental right to trial:

> …Certainly, these rules [English law] have no such restrictive effect in respect of any constitutional grant of governmental power (*Waring* v. *Clarke, supra*), though they do, at least in some instances, operate restrictively in respect of clauses of the Constitution which guarantee and safeguard the fundamental rights and liberties of the individual, the best examples of which, perhaps, are the *Sixth* and *Seventh Amendments*, which guarantee the right of trial by jury. That guaranty has always been construed to mean a trial in the mode and according to the settled rules of the common law, including all the essential elements recognized in this country and England when the Constitution was adopted."[57]

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[54] *See, e.g., Valley Forge Christian College v. Americans United for Separation*, 454 U.S. 464, 475-476 (1982); *Camreta v. Greene*, 131 S. Ct. 2020, 2028 (2011)("Article III of the Constitution grants this Court authority to adjudicate legal disputes only in the context of "Cases" or "Controversies."). Conversely, non-Article III courts can issue advisory opinions. *Ex Parte Bakelite Corporation*, 279 U.S. 438, 450 (1929) ("…These courts, this Court has held, are created in virtue of the power of Congress 'to exercise exclusive legislation' over the district made the seat of the government of the United States, are legislative rather than constitutional courts, and may be clothed with the authority and charged with the duty of giving advisory decisions in proceedings which are not cases or controversies within the meaning of Article III, but are merely in aid of legislative or executive action, and therefore outside the admissible jurisdiction of courts established under that Article.").

[55] *See, e.g.*, *Wright v. Union Central Life Ins*, 304 US 502, 513-516:(1938) ("'The subject of bankruptcies is incapable of final definition. The concept changes. It has been recognized that it is not limited to the connotation of the phrase in England or the States, at the time of the formulation of the Constitution. An adjudication in bankruptcy is not essential to the jurisdiction. The subject of bankruptcies is nothing less than 'the subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief.' This definition of Judge Blatchford, afterwards a member of this Court, has been cited with approval here.'")(footnotes omitted); *Hanover National Bank v Moyses*, 186 US 181, 186 (1902).

[56] *Hanover National Bank v Moyses*, 186 US 181, 192 (1902).

[57] *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R. I. & P. R. Co.*, 294 U.S. 648, 669 (1935).

The bankruptcy power has never been held to allow violation of fundamental rights. To the contrary, the Supreme Court has consistently ruled the application of the bankruptcy power is subject to the Constitution, which protects fundamental and nonfundamental rights.

In 1949, the Supreme Court confronted the issue as to whether the United States District Court sitting in bankruptcy could determine whether the owner of the tracks formerly leased to the debtor-railroad had validly authorized the sale of the tracks to the debtor which the debtor had negotiated to purchase so it could stay in business post-reorganization.[58] The Supreme Court ruled the bankruptcy power unquestionably gives the bankruptcy court power over the debtor, its property, and all rights asserted against it, but the debtor's purchase of formerly leased property from a non-Title 11 debtor does not involve rights asserted against the debtor and therefore the relief requested was outside the bankruptcy power, and the district court lacked jurisdiction to order the sale.[59] The Supreme Court went on to observe the jurisdiction over the solvent lessor's dispute with the debtor asserted by the district court presiding over the railroad reorganization was "an extension of these traditional powers not justified by any provisions of the Bankruptcy Act."[60]

Accordingly, the bankruptcy court in *Purdue Pharma* distinguished *Calloway* on the ground the bankruptcy court's jurisdiction was then narrower than it is today under 28 U.S.C. § 1334(b).[61] While it may have been narrower, the jurisdiction included jurisdiction to "Bring in and substitute additional persons or parties in proceedings under this Act when necessary for the complete determination of a matter in controversy."[62] Therefore, had the Supreme Court believed the bankruptcy power was broad enough to encompass claims of non-debtor creditors against non-debtor shareholders, the grant of statutory subject matter jurisdiction was not an impediment. Put differently, even if Congress were to draft bankruptcy subject matter jurisdiction to incorporate expressly creditors' actions against shareholders, there is no basis in the jurisprudence to believe the bankruptcy power in the constitution authorizes that jurisdictional grant absent a direct impact of each of the actions on the debtor's estate. Additionally, the U.S. Court of Appeals for the Third Circuit ruled in *Combustion Engineering* that parties cannot create subject matter jurisdiction over a third party's actions by rendering a reorganization plan dependent on the third party's contributions.[63] Curiously, *Millennium* does not cite *Combustion Engineering*.

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[58] *Calloway v. Benton*, 336 U.S. 132 (1949) ("*Calloway*").
[59] *Id*. at 147.
[60] *Calloway v. Benton*, 336 U.S. 132, 148 (1949).
[61] *In re Purdue Pharma LP*, 633 B.R. 33, 98 (Bankr. S.D.N.Y. 2021).
[62] Former Bankruptcy Act section 2.a.(6) (1938).
[63] *In re Combustion Eng'g, Inc.*, 391 F.3d 190, 228-229 (3d Cir. 2004) ("…a debtor could create subject matter jurisdiction over any non-debtor third-party by structuring a plan in

Significantly, the Supreme Court's rulings defining aspects of the bankruptcy power have not encompassed anything remotely akin to coerced releases. Rather, they have focused on the relation between the debtor and creditor. Early on, the Supreme Court approved a lower court's attempt to describe the bankruptcy power: "it extends to all cases where the law causes to be distributed, the property of the debtor among his creditors; this is its least limit. Its greatest, is the discharge of a debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject -- distribution and discharge -- are in the competency and discretion of Congress."[64] Of course, discharge normally entails impairing contractual obligations and the bankruptcy power authorizes impairment.[65] The bankruptcy power "would clearly encompass a federal statute defining the mortgagee's interest in the rents and profits earned by property in a bankrupt estate."[66] The Supreme Court has concluded the framers of the constitution understood the bankruptcy power included more than simple adjudication of rights in the res of the debtor's estate, as shown by the first bankruptcy statute authorizing the bankruptcy commissioner appointed by the district court to imprison a person in possession of estate property.[67]

Notably, the bankruptcy power "is not limited to the connotation of the phrase in England or the States, at the time of the formulation of the Constitution," and "[a]n adjudication in bankruptcy is not essential to the jurisdiction."[68] Thus, the fact the shareholders obtaining coerced releases were not Title 11 debtors is not what renders unconstitutional their discharges provided by the coerced releases.

Coerced releases violate multiple sections of the Constitution. The lack of federal bankruptcy power to deprive persons of their trial rights is confirmed by the procedural due process clause of the Fifth Amendment and the Supreme Court's decisions showing the bankruptcy law is subject to the Constitution. Indeed, if the shareholders receiving coerced releases had commenced their own bankruptcy cases, the creditors would have had their day in court. They would be allowed to file and prove their claims against the shareholders' estates and obtain fair distributions from it. The bankruptcy court trials would be nonjury trials because in England in 1789 bankruptcy

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such a way that it depended upon third-party contributions. 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 Resorts Int'l, Inc., 372 F.3d* (internal citations omitted)*…."*).

[64] *Hanover National Bank v Moyses*, 186 US 181, 186 (1902) (quoting Justice Catron in *In re Klein*, decided in the Circuit Court for the District of Missouri, and reported in a note to *Nelson v. Carland, 1 How. 265, 277*).

[65] *Ry Labor Executives Assn v. Gibbons*, 455 US 457, 466 (1982).

[66] *Butner v. United States*, 440 U.S. 48, 54 (1979).

[67] *Central Virginia Community College v. Katz*, 546 U.S. 356, 370-371 (2006).

[68] *Wright v. Union Central Life Ins*, 304 US 502, 513 (1938).

was handled in the equity courts,[69] not the law courts. There is nothing in the Bankruptcy Code remotely suggesting creditors' can constitutionally be deprived of their fundamental trial right and liberty interest to sue the Title 11 debtors' shareholders in state or federal court and enforce whatever judgments they procure either under state law or bankruptcy law.

<u>Coerced Releases Violate the Separation of Powers Principle by the Executive and Legislative Branches Depriving the Judicial Branch of Judicial Cognizance over Common Law Claims</u>

Consistent with the fundamental right to sue, as long ago as 1856, the Supreme Court established precedent governing when a validly pled claim can be resolved as a "public right," without a trial on the merits.[70] It established the rule religiously followed today that if the claim would have been resolved in the law courts in England, as opposed to being determined unilaterally by the sovereign, the claimholder is entitled in federal court to have its claim determined by the Article III judicial power. The Supreme Court ruled: "To avoid misconstruction upon so grave a subject, we think it proper to state that we do not consider congress can either withdraw from judicial cognizance any matter which, from its nature, is the subject of a suit at the common law, or in equity, or admiralty; nor, on the other hand, can it bring under the judicial power a matter which, from its nature, is not a subject for judicial determination."[71] When applied to coerced releases, there is no dispute the creditors' common law tort actions against the shareholders were quintessentially subject to judicial cognizance at common law. Therefore, Congress cannot constitutionally withdraw them from judicial cognizance or authorize any Article III or non-Article III judge to do so. That would be a violation of the judiciary's Article III judicial power and the separation of powers principle whereby a bankruptcy statute enacted by Congress and the President of the United States would prevent a creditor from proving its claim against a shareholder in a jury trial and thereby take over the judiciary's power to determine the claim.

<u>Coerced Releases Also Violate the Separation of Powers Principle by Assigning to the Judicial Branch the Power to Deprive Creditors of Their Day in Court and to Legislate the Requirements for Coerced Releases</u>

The Supreme Court's decisions the last thirty-eight years discussing Article III's application in bankruptcy cases, identify the key issue, but it has been overlooked in most lower courts' jurisprudence discussing coerced releases, including *Millennium*. Starting with *Northern Pipeline* in 1982, the Supreme Court has determined on four

[69] *Katchen v. Landy*, 382 U.S. 323, 336-337 (1966); *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1951 (2015) (CJ Roberts and J Thomas dissent).
[70] *Murray v. Hoboken Land and Improvement Co.,* 59 U.S. 272, 284 (1856).
[71] *Murray v. Hoboken Land and Improvement Co.,* 59 U.S. 272, 284 (1856).

occasions[72] whether a non-Article III bankruptcy judge can constitutionally determine contract and tort claims for money damages of debtors or trustees under Title 11 ("Title 11 debtors") of the United States Code (the "Bankruptcy Code") against other persons or entities who are not Title 11 debtors ("non-Title 11 debtors"). The Supreme Court repeatedly explained the crux of the issue was to carry out the separation of powers principle. Namely, no branch of the federal government should have its powers exercised by either of the other two branches. Therefore, if resolution of any claim requires exercise of the Article III judicial power, the claim can not be determined by judges whose compensation and tenure are controlled by the legislative branch because then the legislature would have economic influence over the judges' decisions. Issues requiring determination by the Article III judicial power can only be constitutionally determined by an Article III judge insulated from influence by the other branches by their lifetime tenure during good behavior and their irreducible compensation.

In each of the four cases the Supreme Court resolved, to carry out the separation of powers principle the court only had to determine whether Article III judicial power was required. If so, an Article III judge and jury were required to avoid the legislative branch from controlling the judges determining the actions.[73] If not, a non-Article III bankruptcy judge could resolve the claim without a jury because if the judiciary branch's Article III judicial power was not required, then there was no danger of the legislative branch controlling use of the Article III judicial power. Thus, the Article III judge and jury were the only variables affecting the carrying out of the separation of powers principle. Regardless of the participation of an Article III judge and jury, in the four Supreme Court

[72] *Northern Pipeline Construction Co. v. Marathon Pipe Line Co*, 458 U.S. 50 (1982) *("Northern Pipeline"); Granfinanciera, S.A. v. Nordberg,* 492 U.S. 33 (1989) ("Granfinanciera"); *Langenkamp v. Culp*, 498 U.S. 42 (1990) ("Langencamp"); and *Stern v. Marshall*, 564 U.S. 462 (2011) ("Stern").

[73] *See Commodity Futures Trading Commission v. Schor,* 478 U.S. 833, 850-851 (1986) ("Article III, *§ 1*, safeguards the role of the Judicial Branch in our tripartite system by barring congressional attempts 'to transfer jurisdiction [to non-Article III tribunals] for the purpose of emasculating' constitutional courts, *National Insurance Co*. v. *Tidewater Co., 337 U.S. 582, 644 (1949)* (Vinson, C. J., dissenting), and thereby preventing 'the encroachment or aggrandizement of one branch at the expense of the other.' *Buckley v. Valeo, 424 U.S. 1, 122 (1976) (per curiam)*. See *Thomas, 473 U.S., at 582-583*; *Northern Pipeline*, 458 U.S., at 57-58, 73-74, 83, 86; *id., at 98, 115-116* (WHITE, J., dissenting). To the extent that this structural principle is implicated in a given case, the parties cannot by consent cure the constitutional difficulty for the same reason that the parties by consent cannot confer on federal courts subject-matter jurisdiction beyond the limitations imposed by Article III, § 2. See, *e. g., United States v. Griffin, 303 U.S. 226, 229 (1938)*. When these Article III limitations are at issue, notions of consent and waiver cannot be dispositive because the limitations serve institutional interests that the parties cannot be expected to protect.").

opinions involving Title II debtors' contract or tort claims for money damages against non-Title 11 entities, the law applicable to the claims remained the same, and the successful plaintiff would receive a judgment enforceable against the defendant's assets.

Seemingly in line with the Supreme Court's four decisions, *Millennium* and other courts addressing coerced releases have focused on whether an Article III judge and jury is required to order the coerced releases. They have done this, however, without identifying each component of the relief embedded in a coerced release and determining whether it can be granted without violating the separation of powers principle underpinning the Supreme Court's four decisions, let alone the Ninth and Tenth Amendments. When that is done, the outcomes change as shown above because coerced releases allow the judicial branch to legislate requirements for coerced releases and allow the legislative branch to authorize the withdrawal from the judicial branch of the power to determine tort and contract claims in accordance with the common law.

One component of the coerced release is deprivation of the plaintiff's right to an Article III jury trial or a state court trial. Therefore, when a court grants a coerced release authorized by the Bankruptcy Code, it exercises power granted by the legislative branch to deprive a litigant of its constitutional right to an Article III jury trial or a state court trial. It also deprives the Article III judicial branch and state courts of their power to resolve the plaintiff's contract and tort claims for money damages. We know from the Supreme Court's four decisions that Congress has no power to deprive litigants or the Article III judicial branch of constitutional rights and duties to hold Article III jury trials to determine common law tort and contract claims simply to aid a Congressional purpose such as a bankruptcy case. For instance, in *Stern,* the Supreme Court held the defendant could not be deprived of an Article III jury trial of the debtor's tort counterclaim for money damages. Pursuant to a coerced release, the entities compelled to release shareholders are deprived of an Article III judge, a jury, a state court trial, and any trial. The jurisprudence makes clear the legislature cannot even dictate fact findings in an Article III trial, let alone the outcome. It is hard to imagine a greater violation of the separation of powers principle than a legislature authorizing the judicial branch, without any trial, to manufacture an alternate outcome of the creditors' common law actions against the shareholders.

It is both hornbook law and logical that neither any one judge nor all Article III judges in the United States are empowered to authorize a violation of the separation of powers principle. Therefore, it does not cure the coerced release's violation of the separation of powers principle if one or more Article III judges order the coerced release.

Unlike those four decisions, requiring an Article III judge and jury does not carry out the separation of powers principle when it comes to coerced releases. If coerced releases are allowed, the only possible statute authorizing them is the Bankruptcy Code enacted by the legislative branch. That means the legislative branch has authorized the withdrawal of tort claims for money damages against non-Title 11 debtors from the Article III judicial power and has transformed them into some type of participation in a chapter 11 plan. Procuring approval from an Article III district judge does not carry out the separation of powers principle. Neither all the Article III district court judges in the United States, nor any one of them can constitutionally relinquish power of the judicial branch, including the power to determine tort claims. Additionally, because the Bankruptcy Code contains no rules for when third parties' tort claims can be transformed into chapter 11 plan participations, the legislature again violates the separation of powers principle by delegating to either a non-Article III bankruptcy judge or an Article III district judge the power to legislate the conditions for the transformation by creating federal common law on a case-by-case basis. In each instance, by violating the separation of powers principle, the legislative branch also imposes collateral damage on the creditor or shareholder having a common law tort claim against a non-Title 11 debtor. They are deprived by the legislative branch of (a) due process in the form of an Article III judge and jury trial, or a state court trial, (b) their day in court, (c) a judgment, and (d) enforcement of the judgment against the shareholder's assets. This violates the Ninth and Tenth Amendments because powers not granted to the federal government, such as the power to deprive citizens of their common law tort claims and rights to prosecute them in accordance with common law, are reserved to the States and the people.

Under the Ninth Amendment, regarded as a truism, powers are reserved to the States and the people if the Constitution does not grant them to the federal government. The Constitution nowhere grants any branch of the federal government the power to deprive a person or entity of its due process right to a day in court, Seventh Amendment jury trial, judgment, and enforcement of its common law contract and tort claims against another person or entity when the latter is not a debtor under Title 11 (a "Title 11 debtor") of the United States Code (the "Bankruptcy Code").

The bottom line is transferring powers of one government branch to another based on judge-made rules while thereby depriving litigants of their constitutional rights to trials in Article III federal courts or state courts, money judgments, and enforcement actions, violates the separation of powers principle. When Congress authorizes bankruptcy courts to take creditors' common law actions against shareholders and to resolve them without trials, the separation of powers principle is violated. Displacing the judicial branch from resolving creditors' actions in accordance with the common law in favor of a legislative bankruptcy process fits the Federalist Papers' description of tyranny.[74]

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[74] James Madison, Federalist Paper # 47 ("The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many, and whether hereditary, selfappointed, or elective, may justly be pronounced the very definition of tyranny.") (February 1, 1788).

Even assuming for argument's sake the Bankruptcy Code authorizes bankruptcy courts to impose coerced releases and to deprive creditors and shareholders of their day in court, it is undisputable the Bankruptcy Code provides no guideline or intelligible principle as to when coerced releases may be imposed. The Supreme Court has held legislative action has "the purpose and effect of altering the legal rights, duties, and relations of persons…"[75] Manifestly, coerced releases alter legal rights, duties, and relations of persons. The courts imposing coerced releases deprive creditors of their legal rights to trials, juries, and enforcement proceedings, among other things, all without guidelines. In essence, the courts make the rules, like legislatures.[76] Courts that grant coerced releases have made the rules on a case-by-case basis, creating standards such as whether they play "an important part in the debtor's reorganization plan,"[77] or whether there are "unusual circumstances" requiring funds from the released party.[78]

Just as the separation of powers doctrine bars Congress from delegating its legislative power to the judicial branch, it also bars Congress from usurping judicial branch powers (a) by legislating final judgments, (b) by imposing rules of decision for pending cases, (c) by granting the executive branch power to review Article III court decisions, or (d) by enacting retroactive legislation that effectively reverses a prior Article III court decision.[79] These prohibitions against the legislative branch controlling or tampering with final Article III judgments strongly suggest Congress cannot, without

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[75] *Ins v. Chadha*, 462 U.S. 919, 952 (1983) (House of Representatives, without Senate and President, violated separation of powers by exercising legislative power when it overruled executive branch decision not to deport alien). Similarly, a statute allowing the SEC to determine whether to prosecute civilly a person for securities fraud within the SEC in front of an administrative law judge or in an Article III court, improperly delegated legislative power to the SEC in violation of the separation of powers principle. *Jarkesy v. SEC*, ___ F.4th ___, No. 20-61007 (5th Cir., May 18, 2022) (Slip Op.) at 18-25.

[76] Most recently, on the ground the lower court engaged in legislative creation of constitutional causes of action better suited for Congress, the Supreme Court overturned a ruling prescribing First Amendment and Fourth Amendment constitutional damage actions against a border-patrol agent for retaliation and use of excessive force. *Egbert v. Boule*, 596 U.S. ___ (June 8, 2022) (Slip Op.).

[77] *In re Drexel Burnham Lambert Group, 960 F.2d 285*, 293 (2d Cir. 1992).

[78] *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002).

[79] *Plaut v. Spendthrift Farm*, 514 U.S. 211, 218, 225 (1995). When, pursuant to a treaty, Congress can determine the method of compensating claimants provided for by the treaty, acts of Article III judges acting as commissioners can be reviewed by the executive branch because the Article III judges are not exercising their Article III judicial power. *United States v. Ferreira*, 54 U.S. 40, 51 (1852) (Because the district court was not acting as an article III court, the Supreme Court ruled it lacked jurisdiction to hear the appeal).

violating the separation of powers principle, authorize a prohibition of a final judgment against the shareholder that the creditor is otherwise entitled to procure.

When a legislature authorizes bankruptcy courts to impose new rules resolving common law disputes without trials, the legislature is usurping the judicial power. Thomas Cooley's treatise on constitutional limitations quotes from an 1851 decision of the Pennsylvania Supreme Court: "And that is not legislation which adjudicates in a particular case, prescribes the rule contrary to the general law, and orders it to be enforced. Such power assimilates itself more closely to despotic rule than to any other attribute of government."[80] Thus, if Congress legislates in the Bankruptcy Code authorization for a judge to take claims against the debtor's shareholders and to impose a remedy different from their common law rights, Congress violates the separation of powers principle, to say the least.

Thus, Congress either unconstitutionally delegated legislative power to courts in violation of the separation of powers doctrine, or the Bankruptcy Code's putative authorization of coerced releases would violate the major question doctrine or the vagueness doctrine while fostering the creation of federal common law rarely allowed because it constitutes judicial lawmaking rather than legislative lawmaking in the alteration of substantive state law.[81] The major question doctrine helps carry out the separation of powers principle. When the executive branch claims Congress delegated power to it, the Supreme Court will look at the history and breadth of the authority asserted and its economic and political significance to determine whether it can decide the issue by deploying a standard exercise of statutory interpretation or by requiring the alleged delegation be supported by clear congressional authorization.[82]

<u>The Bankruptcy Code Does Not Authorize Coerced Releases, Except in Asbestos Cases</u>

As to whether the Bankruptcy Code authorizes courts to grant coerced releases, there are only two Bankruptcy Code sections potentially granting authorization, sections 105(a) and 1123(b)(6). Section 105(a) authorizes the court to issue any order "necessary or appropriate to carry out the provisions" of the Bankruptcy Code. Section 1123(b)(6) allows chapter 11 plans to contain "any other appropriate provision not

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[80] Cooley, Thomas M. *A Treatise on the Constitutional Limitations Which Rest upon the Legislative Power of the States of the American Union*. (2nd ed. Boston: Little, Brown & Company, 1871) at *91 (quoting from Ervine's Appeal, 16 Pa. 256, 266 (1851)), retrieved at: https://repository.law.umich.edu/books/10.
[81] *See Rodriguez v. FDIC*, 140 S. Ct. 713, 717, 589 U.S. ___ (2020) (Gorsuch, J.)**;** *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, 78 (1938); Brubaker, Ralph "Mandatory Aggregation of Mass Tort Litigation in Bankruptcy," 131 Yale L.J.F. 960, 971-981 (2022), available at: https://ssrn.com/abstract=3960117.
[82] *West Virginia v. EPA*, 597 U.S. ___ (June 30, 2022) (Slip Op. at 17, 19) (citing *FDA v. Brown & Williamson Tobacco Corp*, 529 U.S. 1120, 159 (2000), and *Utility Air Regulatory Group v. EPA*, 573 U.S. 302, 324 (2014)).

inconsistent with the applicable provisions" of the Bankruptcy Code. As *Purdue Pharma* ruled: "the Bankruptcy Code does not authorize such non-consensual non-debtor releases: not in its express 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."[83] For example, if a shareholder becomes a chapter 11 debtor under the Bankruptcy Code it cannot procure a discharge of claims against it without assuring creditors they receive at least what they would receive if all the shareholder's assets were liquidated in a chapter 7 case. This requires disclosure and proof of the shareholder's assets and liabilities. A coerced release comes with no such disclosure. Curiously, one of the Second Circuit decisions opining a coerced release is authorized in rare situations, concedes "it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code."[84] The concession shows coerced releases neither carry out nor are consistent with the Bankruptcy Code. Indeed, the basics of bankruptcy administration require every title 11 debtor (other than municipality debtors) to disclose its assets and liabilities within fourteen days of voluntary filings,[85] which is well before a discharge is granted. The court may not grant a discharge to an individual debtor who fails to disclose all assets.[86] The notion that courts, on an *ad hoc* basis, can issue discharges to shareholders without such disclosure thwarts many constitutional protections including the principle that Congress may enact only uniform bankruptcy laws.[87]

In light of the Supreme Court's decision in *Czyzewski v. Jevic Holding Corp.,*[88] the subsequent *Millennium* and *Purdue Pharma* opinions are particularly surprising. In *Jevic*, the Supreme Court reversed the Third Circuit's affirmance of a bankruptcy court order dismissing a chapter 11 case and approving the distribution of the estate's money in a manner violating the priority scheme required in chapter 11 plans and chapter 7

[83] *In re Purdue Pharma, L.P.,* 635 B.R. 26, (S.D.N.Y. 2021). Another district court rejected coerced releases after determining the bankruptcy court lacked subject matter jurisdiction over many of the released claims because they did not relate to the bankruptcy, and lacked constitutional authority to determine them. *Patterson v. Mahwah Bergen Retail Grp., Inc.*, ___ F. Supp. 3d ___, 2022 U.S. Dist. LEXIS 7431 * (E.D. Va. 2022).
[84] *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.), 416 F.3d 136*, 142 (2d Cir. 2005).
[85] Bankruptcy Rules 1007(b)(1)(A), 1007(c).
[86] Bankruptcy Code sections 727(a)(3), 1141(d)(3)(C).
[87] In applying the uniformity requirement to United States Trustee fees each debtor's estate must pay, the Supreme Court ruled the uniformity requirement applies to substantive and administrative bankruptcy laws. *Siegel v. Fitzgerald*, 596 U.S. ___ (June 6, 2022). Thus, the uniformity requirement applies as much to the Bankruptcy Code's disclosure requirements as to its criteria to discharge the debtor from the debtor's debts.
[88] 137 S. Ct. 973 (2017) ("*Jevic*").

cases. The lower court had approved a distribution that "gave money to high-priority secured creditors and to low-priority general unsecured creditors but which skipped certain dissenting mid-priority creditors. The skipped creditors would have been entitled to payment ahead of the general unsecured creditors in a Chapter 11 *plan* (or in a Chapter 7 liquidation)."[89] Nevertheless, in *Millennium and Purdue Pharma*, the courts granted non-Title 11 debtors releases of claims without imposing on the released parties the requirements chapters 7 and 11 impose before a Title 11 debtor can be discharged of any claims. While neither *Millennium* nor *Purdue Pharma* cite *Jevic*, if they had they might have emphasized its *dicta*.

In *Jevic,* without commenting on their propriety, the Supreme Court acknowledges decisions of lower courts approving deviations from priorities in the Bankruptcy Code, and observes that in the record in *Jevic* it could not find "any significant offsetting bankruptcy-related justification" for violating the Bankruptcy Code's priorities, such as promoting the possibility of a confirmable plan.[90] *Millennium* and *Purdue Pharma* each emphasized how the coerced releases were integral to the restructuring and settlements necessary to render confirmable plans possible.[91] While this article explains why, as a statutory matter, the Bankruptcy Code does not allow coerced releases, there can be no absolute certainty the Supreme Court would not countenance a deviation from the statute if only enforcement of the Bankruptcy Code were at issue and there were a justification for the deviation. To the extent coerced releases violate the Constitution, however, it is fair to assume the Supreme Court would bar them regardless of any offsetting justification.

If not for several appellate decisions ruling or implying the Bankruptcy Code authorizes coerced releases in various circumstances,[92] it would be easy to conclude the Bankruptcy Code does not. Although *Millennium* proclaims "[t]he Bankruptcy Court indisputably had 'core' statutory authority to confirm the plan," two circuit courts have long disagreed the statute grants power to compel nonconsensual non-debtor releases in the first place.[93]

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[89] *Jevic*, 137 S. Ct. at 978.

[90] *Jevic*, 137 S. Ct. at 986.

[91] *See Millennium* at 140; *Purdue Pharma* at 72.

[92] *See, e.g.*, *In re Ingersoll, Inc., 562 F.3d 856, 863 (7th Cir. 2009); Menard-Sanford v. Mabey (In re A.H. Robins Co.),* 880 F.2d 694, 702 (4th Cir. 1989)*; Lacy v. Dow Corning Corp. (In re Dow Corning Corp.),* 280 F.3d 648, 658 (6th Cir. 2002); *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 212 (3d Cir. 2000); *Johns-Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52, 66 (2d Cir. 2008), *reversed and remanded on other grounds, Travelers Indemnity Co. v. Bailey,* 129 S. Ct. 2195 (2009).

[93] *American Hardwood, Inc. v. Deutsche Credit Corp. (In re American Hardwoods Inc.*), 885 F.2d 621, 624-626 (9th Cir. 1989), ruled that while the bankruptcy court has subject

To be sure, if non-Title 11 debtors such as the shareholders in *Millennium* file chapter 11 petitions and comply with the applicable provisions of Title 11 of the United States Code ("Title 11"), they can procure discharges from their creditors' claims under the Bankruptcy Code. Whether the Bankruptcy Code allows a non-Title 11 debtor to procure a discharge without complying with Title 11 is another story.

Title 11 provides for discharges of chapter 7, 9, 11, 12, and 13 debtors,[94] but not for non-Title 11 debtors except in asbestos cases.[95] To procure their discharges, title 11 debtors must first comply with a host of financial disclosure requirements.[96] This enables the court and all parties to determine whether the ultimate distribution of the value of each debtor's estate complies with the Fifth Amendment due process requirement that when a debtor is released from its debts, the value of the debtor's estate must be distributed fairly to its stakeholders.[97] In chapter 11 cases, the court

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matter jurisdiction to impose third party releases because they are related to the chapter 11 case, they do not have the power pursuant to Bankruptcy Code section 105(a) to grant a release of a creditor's guarantor because that would run afoul of Bankruptcy Code section 524(e). The court observed the case presented none of the unusual facts of *Menard-Sanford v. Mabey, (In re A.H. Robins Co.)*, *880 F.2d 694 (4th Cir. 1989)*, including that the releases were essential to the plan or that the entire reorganization hinged on them. *In re American Hardwoods Inc.*, 885 F.2d 621, 627 (9th Cir. 1989). *Millennium*'s facts are that "the deal to avoid corporate destruction would not have been possible without the third-party releases." *Millennium*, at 132. Subsequently, the United States Court of Appeals for the Ninth Circuit pointed out that *American Hardwood* only ruled that pursuant to Bankruptcy Code section 524(e) the bankruptcy court cannot discharge a nondebtor from debt the debtor is discharged from, but did not bar exoneration clauses releasing nondebtors from other creditors' claims for "liabilities arising from the bankruptcy proceedings and not the discharged debt." *Blixseth v. Credit Suisse*, ___ F.3d ___, 2020 U.S. App. LEXIS 18524 * 22 (9th Cir., June 11, 2020). In *Robins*, the appellate court affirmed an injunction against creditors paid in full under the plan from suing entities (debtor's directors and attorneys, and insurer and its attorneys) who would have indemnity or contribution claims against the debtor or other impacts on the reorganization. *Id*. at 701-702. *Bank of New York Trust Company, NA v. Official Unsecured Creditors' Committee (In re Pacific Lumber Company),* 584 F.3d 229, 252-253 (5th Cir. 2009), held the release of entities from liability (other than for wilfullness and gross negligence) for proposing, implementing, and administering a chapter 11 plan must be struck from the plan, except for the release and exculpation of the creditors' committee and its members because they have "qualified immunity for actions within the scope of their duties." The court opined that 11 U.S.C. § 524(e) provides a fresh start to debtors and is not intended to release other parties. *Id*. at 252-253.

[94] 11 U.S.C. §§ 727(a), 944(b), 1141(d), 1228, 1328.

[95] *See* 11 U.S.C. § 524(g)(4)(A)(ii).

[96] *See, e.g.*, 11 U.S.C. § 521(a)(1)(A)-(B).

[97] *See Kuehner v. Irving Trust Co.*, 299 U.S. 445, 452 (1937).

may only confirm a chapter 11 plan if it provides the same treatment to each claim in a class.[98]

Conversely, the shareholders released in *Millennium* are not shown to have disclosed any financial data, or how much they were paying their other creditors. It is quite possible if not probable the shareholders were paying all their other creditors in full in cash, while not contributing enough to the value distributed to Millennium's creditors to offset the creditors' fraud claims against the shareholders. *Millennium* does not mention whether the shareholders' assets were being distributed fairly to their creditors and whether the shareholders were treating all similar claims the same way. Additionally, in chapter 11 cases, debtors being released from their claims must pay creditors at least the value they would receive if the debtors were liquidated under chapter 7.[99] The creditors in *Millennium* received no assurance they were receiving from the debtor's shareholders at least what they would receive if the shareholders' property were liquidated and distributed in chapter 7.

The two Bankruptcy Code sections[100] relied on by some appellate courts as authority to impose coerced releases only authorize orders consistent with or to carry out provisions of the Bankruptcy Code. As already shown, the coerced releases discharge entities of claims without imposing the requirements the Bankruptcy Code imposes on Title 11 debtors seeking discharges. Thus, the only way coerced releases can be squared with the Bankruptcy Code is to ignore the Bankruptcy Code's actual provisions on the theory anything critical to the business deal underlying the chapter 11 plan is consistent with Title 11 because it is supposed to foster reorganization. That rationale, however, has no limits. If one critical funder of a chapter 11 plan can require a release from the debtor's shareholders, another can require a release of the debtor from an antitrust or other action, or whatever else the funder makes a condition of its transfer of value to the reorganized debtor.

Outside bankruptcy, the most similar and perhaps only situation allowing a coerced release occurs in limited fund, non-optout class action settlements under Rule 23(b)(1)(B) of the Federal Rules of Civil Procedure. The United States Supreme Court does not affirm approval of such settlements unless the record proves the entity being released is actually a limited fund, meaning the claims against it exceed the fund's amount.[101] *Millenium's* plan would not be approved under that constraint. In *Ortiz v.*

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[98] 11 U.S.C. § 1123(a)(4).
[99] 11 U.S.C. § 1129(a)(7).
[100] 11 U.S.C. §§ 105(a), 1123(b)(6). 11 U.S.C. § 1142(b) is also deployed as statutory authority for coerced releases because it empowers the court to order any necessary party to deliver property or "to perform any other act…necessary for the consummation of the plan." Section 1142(b), however, is not triggered until there is a confirmed plan requiring a coerced release. It does not on its own authorize coerced releases, consistent with all the Bankruptcy Code's other provisions.
[101] *See Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2312 (1999).

*Fibreboard Corp.*,[102] the Supreme Court explained that for a limited fund class action settlement to be approved under Fed. R. Civ. P. 23(b)(1)(B), it must satisfy certain conditions making it equitable to bind class members to a fund insufficient to pay them in full: (a) the maximum size of the fund must be less than the maximum claims, (b) the entire fund must go to the claimants, and (c) the claims must share a common theory of liability.[103] Additionally, the Supreme Court opined there must be a necessity to deprive the claimant of his day in court and his jury trial.[104] In *Millenium*, there is no showing the primary shareholders' assets are less than the total claims, all their assets are not going to claimants, and not all the creditors may have the same claims. The Supreme Court also opined that the existence of a negotiated settlement does not eliminate the need for proof the fund is less than the claims.[105]

<u>If Coerced Releases were Constitutional, Non-Article III Judges Could Impose Them</u>

*Millennium* concluded the non-Article III court could order the coerced release because it was "integral to the restructuring,"[106] which was *Millennium's* mode of communicating it was within the bankruptcy power and susceptible of being constitutionally ordered by a non-Article III court. *Millennium* reached that conclusion by inferring it from *Stern v. Marshall,*[107] which explained relief "integral to the restructuring of the debtor-creditor relationship" can be ordered by a non-Article III court.[108] Notably, *Stern* did not involve the restructuring of the creditor-shareholder relationship which was the issue in *Millennium*. More importantly, in *Stern* the United States Supreme Court was determining when an action for money damages by a Title 11 debtor or trustee against a third party, needed to be resolved by an Article III judge to carry out the separation of powers principle. The coerced release in *Millennium*, however, meant discharging the shareholders from creditors' claims and depriving the creditors of their rights to prove their claims against the shareholders and to enforce them. To the extent

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[102] *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295 (1999).
[103] *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2312 (1999).
[104] *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2321 (1999); *see Martin v. Wilks*, 490 U.S. 755, 762 (1989).
[105] *Ortiz v. Fibreboard Corp.*, 119 S. Ct. 2295, 2302 (1999) ("We hold that applicants for contested certification on this rationale (limited fund theory under Fed. R. Civ. P. 23(b)(1)(B)) must show that the fund is limited by more than the agreement of the parties, and has been allocated to claimants belonging within the class by a process addressing any conflicting interests of class members.").
[106] *Millennium* at 140.
[107] 131 S. Ct. 2594, 2610 (2011) *("Stern").*
[108] *Stern* at 197, 199.

Millennium relied on dicta in Stern, the Supreme Court makes clear it is “not bound to follow our dicta in a prior case in which the point now at issue was not fully debated.”[109]

Accordingly, *Millennium* did not need to reason backwards from *Stern*. *Millennium* only needed to heed the Supreme Court’s teachings that the question whether an Article III judge is required is answered by determining whether the relief requested would have been tried in the law courts or equity courts in England in 1789.[110] Because it is clear that bankruptcy commissioners in the equity courts granted discharges,[111] an Article III judge is not required.

Conversely, before a non-Article III judge can constitutionally grant the discharge, an Article III judge would have to determine it is constitutional (which it is not) to deprive creditors of their fundamental right to prove their claims against the shareholders. To the extent, if any, a federal judge can remove a private right from determination by the Article III judicial power in a jury trial or by a state court, only an Article III judge may do so based on Supreme Court precedent that the facts and laws necessary to deprive a litigant of constitutional rights must be determined by an Article III judge.[112]

[109] *Central Virginia Community College v. Katz*, 546 U.S. 356, 363 (2006) (following *Cohens v. Virginia,* 19 U.S. 264, 399-400 (1821), providing "It is a maxim not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision"); *accord S. Union Co. v. United States*, 567 U.S. 343, 352 n. 5 (2012); *Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1*, 551 U.S. 701, 737 (2007).
[110] *Northern Pipeline*, 458 U.S. at 90; *Stern*, 564 U.S. at 484.
[111] *Wellness Int’l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 1951 (2015) (J. Roberts dissenting).
[112] *Crowell v. Benson*, 285 U.S. 22, 60 (1932).

# Faculty

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