American Bankruptcy Institute

2023 Alexander L. Paskay Memorial Bankruptcy Seminar

Business Breakout

Update on Third-Party Releases, Injunctions and Bar Orders

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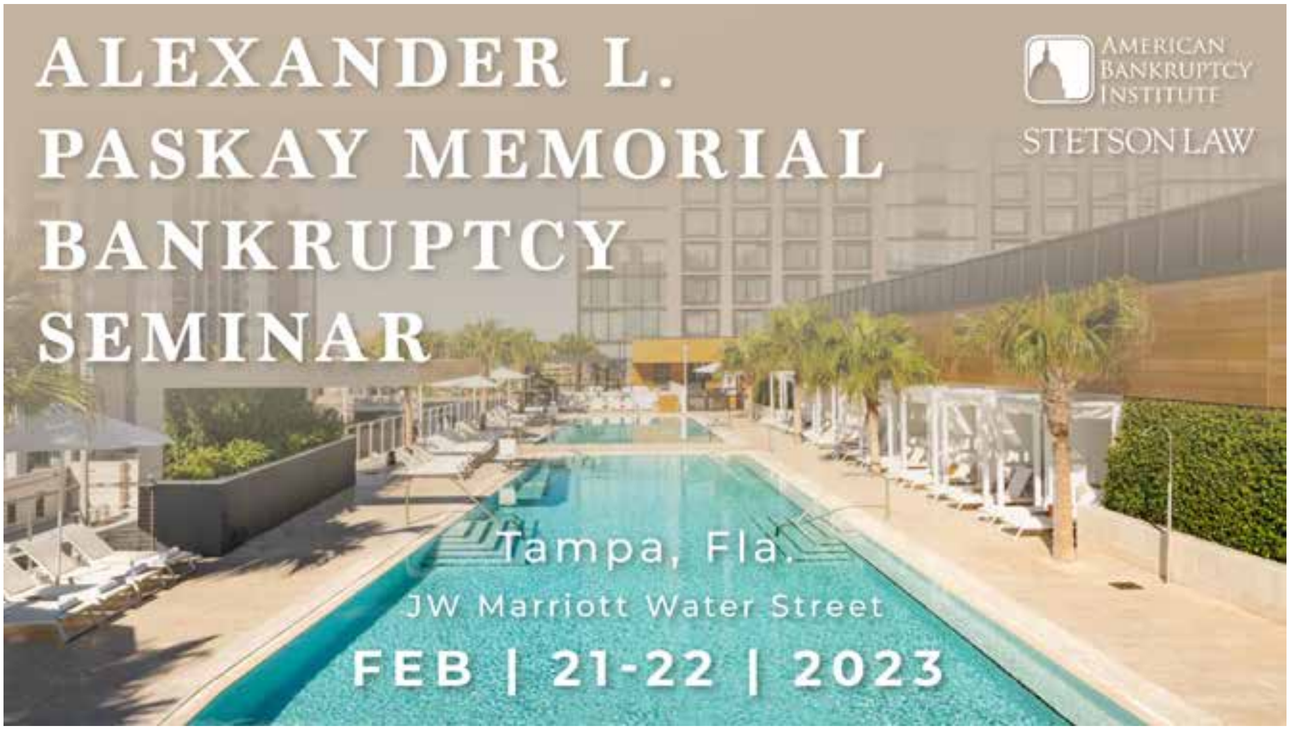

BUSINESS BREAKOUT:
Update on Third-Party Releases, Injunctions, and Bar Orders

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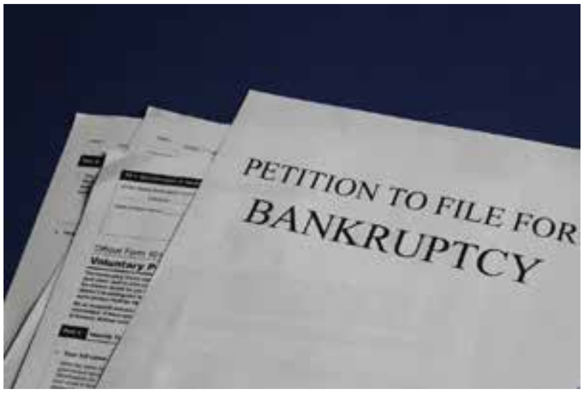
ALEXANDER L. PASKAY MEMORIAL BANKRUPTCY SEMINAR

The Foundations of a Bankruptcy Court Injunction



- Landis v. N. Am. Co. 299 U.S. 248 (1936)
- Bankruptcy Code Section 105

ALEXANDER L. PASKAY MEMORIAL BANKRUPTCY SEMINAR

Purdue Pharma, L.P. and overview of Circuit Decision

- Bankruptcy Opinion – 633 B.R. 53 (Bankr. S.D.N.Y 2021)
- District Court Opinion – 635 B.R. 26 (S.D.N.Y. 2021)
- Boy Scouts of Am. & Delaware BSA, LLC, 642 B.R. 504 (Bankr. D. Del. 2022)
- In re LTL Management, LLC 22-2023 (3d Cir Jan. 30, 2023) (J&J no two step)

11th Circuit Status

- Interim Relief – Section 105 and Otero Mills, 21 B.R. 777 (Bankr. D. N.M. 1982)
- Settlement Agreement: Munford, Inc., 97 F.3d 449 (11th Cir. 1996)
- Plan: Seaside Engineering & Surveying, Inc., 780 F.3d 1070 (11th Cir. 2015)
- In re: Centro Group, LLC 2021 WL 515 8001 (11th Cir. 2021)

Plan and Practical Issues

Optout → Notice → Waive Claim/ Jurisdiction → Temporary Injunction

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

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2023 ABI Alexander L. Paskay Memorial Bankruptcy Seminar

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For a Discussion with
Steve Miller, Chairman of the Board of Purdue Pharma
2022 ABI Alexander L. Paskay Memorial Bankruptcy Seminar
Tampa, Florida
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Introduction: The Purdue Pharma Bankruptcy

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

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

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

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

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

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

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

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

[3] The litigation in *Purdue* did not end with entry of the Confirmation Order. *See, infra.*

parties providing compensation to claimants in exchange for the release of their liabilities, which makes the reorganization feasible.[4]

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

- the release is important to the plan,
- the enjoined claims would be channeled to a settlement fund rather than extinguished,

the estate receives substantial consideration in return,

- the released claims would otherwise indirectly impact reorganization by way of indemnity or contribution, and
- the plan otherwise provided for the full payment of the enjoined claims.

Id. at 141-42.

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

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

The Majority Approach

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

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

- *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973 (1st Cir. 1995) – holding that the bankruptcy court made the requisite predicate finding for a broad "incidental" injunction as enumerated in *A.H. Robins*: (i) the injunction was essential to garner the plan contributors' cooperation in the debtor's reorganization, and (ii) the debtor's creditors overwhelmingly approved the injunctive provisions. Interestingly, the issue arose over the post-confirmation violation of a chapter 11 plan injunction when the debtor's affiliate sued former counsel for legal malpractice in the Massachusetts Superior Court. The issue on appeal was not in the context of the appeal of the confirmation order, but rather a collateral estoppel issue of the plan releases.

- *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000) – holding that nonconsensual releases are allowed only with specific findings of fairness if they are necessary to the reorganization. The court declined to decide whether there is a blanket rule against nonconsensual releases but rather assumed the most

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

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

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

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

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

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

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

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

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[7] Bankruptcy courts in the Third Circuit have generally held that consent for releases may be implied in the absence of the execution by a creditor or equity holder of an opt-out form (usually contained as part of the plan ballot). *See In re Boy Scouts of Am. & Delaware BSA, LLC*, 642 B.R. 504, 674 (Bankr. D. Del. 2022) (finding that consent to third-party releases could be inferred from failure to respond to the opt-out notice or to object to solicitation, where (1) the need to opt-out was prominently placed on the first page of each ballot, in bold, all caps and surrounded by a box; (2) the ballots contained the full language of the releases, those entitled to service were served with the plan, disclosure statement, ballot and the solicitation procedures order; (3) those parties in unimpaired classes who were not entitled to vote were served with a notice of non-voting status; and (4) notice was published in various publications with large or targeted audiences, and the percentage of claimants who chose to opt-out of the releases was significant on the whole). *But see*, *In re Emerge Energy Servs. LP*, No. 19-11563 (KBO), 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019) wherein Judge Owens held that "the Court cannot on the record before it find that the failure of a creditor or equity holder to return a ballot or Opt-Out Form manifested their intent to provide a release. Carelessness, inattentiveness, or mistake are three reasonable alternative explanations."

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

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

- *Behrmann v. Nat'l Heritage Found., Inc.*, 663 F.3d 704 (4th Cir. 2011) – holding that the bankruptcy court's findings that the release provisions of the plan, which exculpated certain third parties only with respect to claims to be brought by parties-in-interest that had filed a proof of claim or were given notice of debtor's bankruptcy, for acts or omissions arising out of the operations of the debtor's business through the effective date of the plan, did not have the specific factual findings to support such relief.[9] In so holding, the court the found the *Dow Corning* seven-part test and the *Railworks*[10] four part test instructive, stating that nonconsensual third-party releases could only be upheld if:

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

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

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

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

- *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002) – holding that under certain circumstances, a bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor to facilitate a chapter 11 reorganization plan when the following factors are present:

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

  - The non-debtor has contributed substantial assets to the reorganization;

  - The injunction is essential to the reorganization, namely the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;

  - The impacted class(es) has overwhelmingly voted to accept the plan;

  - The plan provides a mechanism to pay all, or substantially all, of the class(es) affected by the injunction;

  - The plan provides an opportunity for those claimants who choose not to settle to recover in full; and

  - The bankruptcy court made a record of specific factual findings that supports its conclusions.

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

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

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

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

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

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

title." Section 524(e) provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

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

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

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

The Minority Approach

In contrast, a minority[14] of the courts of appeal have held that nonconsensual third-party releases in a plan are impermissible under the Bankruptcy Code.[15] Those cases provide that the equitable powers of § 105(a) do not create "residual authority" that is not expressly found in the statutory language of the Bankruptcy Code and may not be exercised in a manner that is inconsistent with other, more specific, provisions of the Code. These courts generally interpret § 524(e) as precluding bankruptcy courts from discharging the liabilities of non-debtors and prohibit nonconsensual third-party releases as a result. *See In re Highland Capital Management*, L.P., 48 F.4th 419 (5th Cir. 2022) (§ 524(e) bars third-party exculpations of non-debtors absent express authority in the Bankruptcy Code; exculpation is limited to the debtor, creditors' committee and its members for conduct within the scope of their duties[16]); *In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009) (holding that § 524(e) only releases the debtor, not co-liable third parties and determining that only members of the creditors' committee had qualified immunity

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

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

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

[16] The Fifth Circuit relied upon § 1103(c) and the court's prior decision in *Baron v. Sherman (In re Ondova Ltd.)*, 914 F.3d 990, 993 (5th Cir. 2019) (per curiam) as the statutory authority for this ruling.

for actions taken within the scope of their duties pursuant to § 1103(c)); *Ad Hoc Grp. Of Vitro Noteholders v. Vitro S.A.B. de C.V. (In re Vitro S.A.B. de CV)*, 701 F.3d 1031, 1061 (5th Cir. 2012) (noting that prior 5th Circuit precedent "seem[s] broadly to foreclose non-consensual non-debtor releases and permanent injunctions"); *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995) (determining that § 524(e) displaces a bankruptcy court's equitable power under § 105(a) to order permanent relief against a non-debtor, and precluding a bankruptcy court from discharging the liabilities of non-debtors); *Landsing Diversified Props.-II v. First Natl Bank & Trust Co. (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600-01 (10th Cir. 1990), *modified sub nom. Abel v. West*, 932 F.2d 898 (10th Cir. 1991) (holding that the supplementary equitable powers of § 105(a) may not be exercised in a manner that is inconsistent with § 524 and determining that a temporary stay during the bankruptcy may be permissible to facilitate reorganization, but a permanent injunction in a plan to insulate non-debtors from actions of other non-debtors post-confirmation is not permitted.).

Recent Developments

I. *Purdue Pharma*

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

(1) Did the Bankruptcy Court have subject matter jurisdiction to impose a release of non-debtor claims? The district court determined that the bankruptcy court's "related to" jurisdiction over any civil proceedings that "might have any conceivable effect" on the estate included the civil proceedings asserted against the non-debtor Sackler Family. Therefore, the district court found that the bankruptcy court had subject matter jurisdiction to approve the Section 10.7 Shareholder Release (which consisted of direct claims of third parties against the non-debtor Sackler Family members, as long as the debtor's conduct or the claims asserted against it are a legal cause or a legally relevant factor).[17]

(2) Did the Bankruptcy Court have statutory authority to approve the non-debtor releases of direct claims against the Sackler Family?[18] Relying on the U.S. Supreme Court's holding in *Stern v. Marshall*, the district court found that neither § 105(a) nor § 1123(a)(5) and (b)(6) provide a bankruptcy court with statutory authority to order the non-consensual release of third-party claims against non-debtors in connection with the confirmation of a chapter 11 bankruptcy plan. The district court also determined that bankruptcy courts do not have "equitable authority" or "residual authority," absent a specific, substantive grant of authority in the Bankruptcy Code. Approval of a non-debtor non-consensual third-party release is a non-core proceeding because it relates to a proceeding over which the bankruptcy

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

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

court merely has "related to" subject matter jurisdiction. In that instance, unless all parties consent to the bankruptcy court's entry of a final judgment disposing of that proceeding, the bankruptcy court is without the constitutional power to enter such a judgment, which the court found included a third-party release. Merely including the non-consensual third-party release in a plan of reorganization does not manufacture the constitutional authority for the bankruptcy court to exercise authority over a proceeding involving solely non-debtor third parties.

Judge McMahon also provided an extensive survey of federal circuit law on the subject of non-consensual releases of third-party claims against non-debtors. The district court then analyzed the various sections of the Bankruptcy Code that Judge Drain relied upon to determine that he had authority to approve the non-debtor releases. Ultimately, the district court determined that none of §§ 1123(a)(5), 1123(b)(6), 1129(a)(1), nor the concept of residual authority, confers a substantive right allowing a bankruptcy court to approve a release to enforce that right pursuant to § 105(a). Moreover, Judge McMahon was unable to conclude that congressional silence should be deemed consent to an expansion of the non-debtor releases authorized in asbestos bankruptcy cases under § 524(g).

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

Based upon this ruling, the district court vacated the bankruptcy court's confirmation order in *Purdue*. Judge McMahon acknowledged that other issues were raised on appeal, which she chose not to address unless her order is reversed on appeal. Given the critical issues at stake in this case, the parties sought, and the district court granted, an interlocutory appeal to the Second Circuit Court of Appeals. On January 27, 2022, the Second Circuit set a briefing schedule and conducted oral argument on April 29, 2022. As of the date of preparation of this article, no decision has yet been rendered by the Second Circuit.

The objecting parties in the underlying bankruptcy case engaged in settlement discussions with the Sackler Family following issuance of the district court opinion, pursuant to an order of the Bankruptcy Court entered on January 3, 2022. Those settlement discussions occurred in the context of a mediation conducted by former Bankruptcy Judge Shelley C. Chapman. On March 9, 2022, the bankruptcy court approved a revised settlement term sheet over the objection of the Department of Justice and 20 U.S. states, including Florida. The revised settlement term sheet includes payments totaling $5.5-6 billion. *In re Purdue Pharma L.P., et al.*, No. 19-23649 (Bankr. S.D.N.Y. filed Sept. 15, 2019) [ECF Nos. 4410 and 4503]. The bankruptcy court's order approving the revised settlement term sheet with Purdue, the Sackler Family and the objecting creditors is expressly conditioned on an appropriate order from either the Second Circuit or the District Court permitting the consummation of Purdue's plan as enhanced by the provisions of the revised settlement term sheet. Given that the Second Circuit has not ruled yet, the billions of dollars in settlement funds earmarked for opioid victims and for various states to address the opioid crisis are held in abeyance.

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

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

The district court was extremely troubled by the adequacy of the notice to the debtors' shareholders. The debtors' noticing agent was unable to confirm how many notices were actually received by shareholders, who had to be served, in many cases, through a nominee who held the shares. The district court also determined that the opt-out provision included in the notice was deficient because it failed to provide the requisite notice required under the seven-factor test adopted by the Fourth Circuit in *Behrmann*. According to the district court, merely affording a shareholder the right to opt out of the settlement without simultaneously seeking affirmative consent by the shareholder to the exercise of jurisdiction by an Article I judge over a non-core matter also made the shareholder notice inadequate.[19]

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

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

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

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

III. *Mallinckrodt*

In February 2022, Judge John Dorsey of the Bankruptcy Court for the District of Delaware approved third-party releases in Mallinckrodt PLC and its affiliated debtors' ("Mallinckrodt") Fourth Amended Joint Plan of Reorganization[20] (the

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

"Plan"). Mallinckrodt filed for chapter 11 protection in October 2020 in part to address over 3,000 opioid lawsuits filed against it. Its Plan included third-party releases of opioid claims (the "Opioid Releases") and actions arising out of Mallinckrodt's business, restructuring, and the purchase, sale or rescission of any security or indebtedness prior to the Plan's effective date (the "Non-Opioid Releases").

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

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

Judge Dorsey examined past Third Circuit precedent[21] indicating that a bankruptcy court has core statutory authority to approve a plan but that statutory

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

authority does not necessarily mean that the court has constitutional authority.[22] He observed that bankruptcy courts must evaluate the content of the plan to determine whether the issue is "integral to the debtor-creditor relationship."[23] He also observed that non-consensual third-party releases should be analyzed carefully and approved only if they meet "exacting standards"[24] in "extraordinary cases."[25] The court cited *Continental* for the proposition that the hallmarks of a permissible release are "fairness, necessity to the reorganization, and specific factual findings to support the conclusions."[26]

Taking all those principles into account, the court found that the releases were necessary to the reorganization and approved them.[27] Judge Dorsey analyzed testimony about the importance of the releases to Mallinckrodt's reorganization, the extensive negotiations that took place, the fairness of the releases to the claimants, and the consideration offered to the claimants. With respect to consideration, the court noted that claimants' potential recovery would likely be greater under the

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

[23] *Id*.

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

[25] *Id*. at *29.

[26] *Id*.

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

settlement than in other alternative scenarios. In addition, Judge Dorsey concluded that the releases also satisfied the *Master Mortgage* factors.[28]

The court also addressed the U.S. Trustee's argument that the releases violated claimants' due process rights. Specifically, the U.S. Trustee argued that the notice for the releases was unclear about what rights would be extinguished. The court evaluated (i) testimony that 91% of the U.S. adult population and 82% of the Canadian adult population received notice and (ii) evidence about Mallinckrodt's extensive noticing procedures. In addition, the court acknowledged that while the language about what claims could be extinguished was "dense", there were several factors that mitigated the U.S. Trustee's concerns. Among those factors was the establishment of an opioid trust that would allow claimants a source of recovery. Because there was no claims bar date, both future claimants and claimants who did not receive notice would have the ability to access the funds. Taken together, the court determined that the combination of factors protected the claimants' due process rights.

IV. *Boy Scouts of America*

In July 2022, Judge Laurie Selber Silverstein of the Bankruptcy Court for the District of Delaware issued an opinion approving major components of the chapter 11 plan of the Boy Scouts of America ("BSA"), including most of its third-party releases, consistent with *Mallinckrodt* but in conflict with *Purdue Pharma* and *Ascen*a.[29] The

[28] *Id*. at *41.

[29] *In re Boy Scouts of Am. & Delaware BSA, LLC*, 642 B.R. 504 (Bankr. D. Del. 2022).

opinion addressed the appropriateness of the following third-party releases of non-debtors contained in the plan:

- Releases by holders of abuse claims relating to scouting against local councils, chartered organizations, settling insurance companies and their respective representatives; and
- Broad releases by holders of claims against all released parties from any claims existing before the effective date of the plan related to the debtors or their estates or assets, in connection with which certain holders of claims were given an opportunity to opt out of the third-party releases on ballots, if in a voting class, or by objecting to the plan, if in a nonvoting class.

The UST and certain claimants challenged the scouting-related releases on the basis that the bankruptcy court lacked subject matter jurisdiction to approve third-party releases and that the scouting-related releases were not fair and necessary to the reorganization, as required by Third Circuit precedent set forth in *Continental*.[30] Certain claimants also objected to the third-party release of The Church of Jesus Christ of Latter-day Saints, arguing that releases for claims against the church that were independent of abuse within the scouting ranks should not be approved. The UST also challenged opt-out releases on the basis that they were not consensual and violated due process rights, and further objected to releases given by 22 categories of

[30] *Id.* at 587 (characterizing *Continental* as setting forth the "hallmarks" of permissible, nonconsensual releases, namely: fairness and necessity to the reorganization supported by specific factual findings).

persons related to releasing parties who likely did not receive notice they would be providing releases.

Judge Silverstein found that she had jurisdiction to approve the third-party releases by virtue of her jurisdiction over plan confirmation and the high degree of interrelated and identity of interest between the debtors and the released parties. The court reasoned that approval of the scouting-related releases was permissible under §§ 105(a), 1123(a)(5), and 1123(b)(6), and explained that because such approval is neither expressly authorized under nor inconsistent with other provisions of the Bankruptcy Code, the *Continental* decision serves as an "[aid to] the court in navigating between these two poles."[31]

Judge Silverstein ultimately concluded that the scouting-related releases — excluding The Church of Jesus Christ of Latter-day Saints releases — satisfied the *Continental* standard because they were fair and necessary to the reorganization. Judge Silverstein also found that the scouting-related releases were necessary to plan confirmation and to ensuring that the BSA's scouting program could continue.

Analyzed under a jurisprudential factor test, the relevant factors were considered fair because:

- The plan provided 100% payment of all or substantially all abuse claims;
- The plan provided for a timely assessment and payment of abuse claims and equal treatment across claimants under the trust distribution procedures;

[31] *Id.*, at 594.

- The scouting-related releases were consistent with how claimants historically brought and settled claims;
- The plan was accepted by over 85% of the class consisting of 82,209 direct abuse claimants, which the bankruptcy court found represented an overwhelming acceptance;
- Without the plan, litigation would result in either claimants racing to the courthouse or a BSA-only bankruptcy plan yielding a pennies-only recovery; and
- The inclusion of negotiated youth protections in the plan was a critical piece of bringing survivors justice and obtaining their approval of the plan.

The court declined, however, to approve the scouting-related releases in favor of The Church of Jesus Christ of Latter-day Saints for non-abuse claims, concluding that it was unclear whether the evidence supported granting them and that those releases were too broad because they would cover unrelated claims against the church.

With respect to the UST's objections regarding opt-out releases, the court found that these opt-out releases were appropriate under the circumstances and that claimants' due process rights were not violated. Judge Silverstein examined the extent of the notice of the opt-out releases and found it sufficient where there was abundant evidence in the record that claimants received notice of the proposed releases, including that they were prominently featured on the ballot, in the disclosure statement, and in widely disseminated published notices, among other places, and that many voters — over 27,000 — elected to opt out of the releases. However, the court declined to find that certain related parties received notice and accordingly did not approve the opt-out releases as to those parties.

Shielding Third Parties in Bankruptcy: Extensions of the §362 Automatic Stay and Imposing §105 Injunctions under the Bankruptcy Code

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One Sunday night in August 2021, bankruptcy law, plans of reorganization and third party releases and injunctions became notoriously part of popular culture when John Oliver, the host of *Last Week Tonight with John Oliver*, exclaimed the following regarding the proposed plan of reorganization and incorporated non-consensual releases of third party, *non-derivative* claims against non-debtors in connection with the confirmation of a Chapter 11 bankruptcy plan in the bankruptcy case *In re: Purdue Pharma, L.P. et al.*, 633 B.R. 53, (Bankr. S.D.N.Y. 2021):[1]

> [T]he really insidious part is that while there are about 400 civil suits naming the Sacklers themselves, the family will agree to the $8 billion settlement only with a non-consensual third-party release precluding all future individual liability. This thing is bullshit because if they get it, all current lawsuits against the Sacklers evaporate, and no future lawsuits can be filed, meaning that the Sacklers, who didn't file for personal bankruptcy themselves, remember, are basically off the hook. And if it sounds weird to you that a company can basically declare bankruptcy and then a bunch of individuals get shielded from liability, that's because it is.[2]

While a request for injunctive relief on behalf of non-debtor third parties is not new to bankruptcy courts, the granting of extensions of the automatic stay pursuant to 11 U.S.C. §362 or injunctions (releases and bar orders) pursuant to 11 U.S.C. §105 is certainly not commonplace. In *Purdue Pharma*, in addition to other relief, the debtors sought and obtained from the bankruptcy court a non-consensual release of third party *non-derivative* claims against non-debtors as part of the confirmation of its plan of reorganization.[iii] However, on appeal the district court, *In re: Purdue Pharma, L.P. et al.*, 635 B.R. 26, 115 (S.D.N.Y. 2021), overturned the bankruptcy court and held that the Bankruptcy Code neither expressly nor impliedly provides authority to confirm a Chapter 11 plan containing such a broad and expansive non-consensual release of third party *non-derivative* claims against non-debtors. In its reasoning, the district court rejected the argument that §105 and §1123 of the Bankruptcy Code support the imposition of such releases and further relied on the specificity of §524(g) and (h), the only Bankruptcy Code sections which expressly authorize third party releases in limited circumstances (asbestos cases), to hold that none of these sections could be interpreted to provide the court with the expansive authority to impose this broad non-consensual releases of third party *non-derivative* claims against non-debtors.[iv] The *Purdue Pharma* case is now on appeal before the Second Circuit and may ultimately be before the U.S. Supreme Court due to the split of authority amongst the U.S. courts of appeals on the imposition of injunctions (releases and bar orders) to enjoin a non-consenting third party from asserting claims against non-debtors.[v]

Bankruptcy courts are essentially "courts of equity, and their proceedings inherently proceedings in equity."[vi] Traditionally injunctive and equitable relief have been used by bankruptcy courts to accomplish the primary purposes of Chapter 11: (i) preserve going concern; and (ii) maximize property available to satisfy creditors.[vii] Requests for injunctive relief from bankruptcy courts usually arise in four circumstances: (i) requests to extend the automatic stay provisions of §362(a) to third party non-debtors to prevent a creditor from commencing or continuing litigation against a non-debtor; (ii) an adversary proceeding under §105(a) seeking an injunction to prevent a creditor from commencing or continuing litigation against a non-debtor or asserting claims against potential property of the bankruptcy estate; (iii) a court approved settlement agreement concluding litigation between the debtor and third parties which contains an injunction (release, bar order or channeling injunction) permanently enjoining third party claims against non-debtors pursuant to §105(a); or (iv) a plan of reorganization which contains an injunction (release, bar order or channeling injunction) permanently enjoining third party claims against non-debtors pursuant to §105(a).

<u>Injunctive Relief under §362(a)</u>:

While it is "universally acknowledged that an automatic stay of proceedings accorded by §362 may not be invoked by entities such as sureties, guarantors, co-obligors, or others with a similar legal or factual nexus to the ... debtor," there are "unusual circumstances" in which federal courts have extended the protections of the automatic stay to non-debtor third parties.[viii] The primary case establishing this proposition is *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994 (4th Cir.1986). In *A. H. Robins*, the Fourth Circuit determined (in the mass tort context) that where "there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that a judgment against the third-party defendant will in effect be a judgment or finding against the debtor" or where suit against a third-party defendant sought "possession or control over property of the debtor," a stay may be warranted for the third-party defendant.[ix] Unusual circumstances may occur when a non-debtor defendant "is entitled to absolute indemnity by the debtor on account of any judgment that might result against them in the case."[x] Federal courts have also extended the automatic stay to non-debtor third parties where stay protection was deemed essential to the debtor's efforts of reorganization and where the debtor is at risk of being collaterally estopped in subsequent suits.[xi]

However, in situations where "unusual circumstances" are not sufficiently present to justify extending the automatic stay provided by §362, litigants can still seek a stay of the proceedings against the non-debtor defendants pursuant to the court's own inherent authority. As explained by the Supreme Court in *Landis v. N. Am. Co.*, 299 U.S. 248, 254–55 (1936):

> the power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants. How this can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance.

A stay of the proceedings is evaluated based upon a balancing test in which the movant bears the burden of showing either "a clear case of hardship or inequity" if the case proceeds, or little possibility the stay will harm others.[xii] Courts weigh several factors such as whether a stay will: (i) unduly prejudice or tactically disadvantage the non-moving party; (ii) simplify the issues and streamline trial; and (iii) reduce the burden of litigation on the parties and on the court.[xiii] Courts have stayed proceedings to avoid piecemeal litigation where all claims and counter-claims are comprised of common questions of law and fact, to conserve judicial resources and in circumstances where there is a risk of inconsistent judgments against the parties.[xiv] Notably, "[a] district court's inherent power to stay proceedings is not mitigated or obviated by § 362(a)."[xv]

Injunctive Relief via an Adversary Proceeding under §105(a):

Pursuant to §105(a) of the Bankruptcy Code, "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." *11 U.S.C. § 105(a)*. "The issuance of an injunction under section 105(a) is governed by the standards generally applicable to the issuance of injunctive relief in non-bankruptcy contexts."[xvi] Requests for injunctive relief must be brought by adversary proceeding except when a chapter 9, chapter 11, chapter 12, or chapter 13 plan provides for the relief.[xvii] While it is true that 11 U.S.C. § 105(a) provides bankruptcy courts broad power to issue any order that is "necessary or appropriate" to the reorganization effort, "this broad authority does not allow the bankruptcy court to apply a less stringent standard for granting injunctive relief for the benefit of non-debtor defendants than is traditionally required for the issuance of any injunction."[xviii]

A bankruptcy court may enjoin a creditor's action against a third party, if it finds that failure to enjoin the action would affect the bankruptcy estate and would adversely or detrimentally influence and pressure the debtor through that third party. *In re Otero Mills, Inc.*, 21, B.R. 777, 778 (1982). This authority to enjoin assures that a creditor may not do indirectly that which he is forbidden to do directly.[xix] In determining whether an injunction to enjoin a creditor's action against a codebtor or guarantor is appropriate, the debtor must show: (i) irreparable harm to the bankruptcy estate if the injunction does not issue; (ii) strong likelihood of success on the merits; and (iii) no harm or minimal harm to the other party or parties.[xx] Additionally, in exercising sound discretion, courts of equity should pay particular regard to the public consequences of employing the extraordinary remedy of injunction.[xxi] Typically, a debtor demonstrates irreparable harm will occur to the bankruptcy estate by establishing economic harm to the estate and the debtor's ability to reorganize. In *Otero Mills*, the debtor argued that irreparable harm would occur if the creditor was permitted to foreclosure on property the debtor's president and shareholder owned and intended to sell so the proceeds could be contributed to the estate for the benefit of all creditors.[xxii] The debtor asserted that an orderly sale of the property would result in a realization of more money to pay all of the debtor's creditors rather than a foreclosure sale.[xxiii] In addition, the debtor presented evidence that other creditors were not likely to cooperate or to give the debtor a chance to sort out its financial problems if they perceived one creditor being allowed a "first crack" at the assets which were earmarked to pay all creditors.[xxiv] Based upon this uncontroverted evidence, the court found that irreparable harm would come to the debtor if the injunction was not issued.[xxv]

In the bankruptcy context, reasonable likelihood of success is equivalent to the debtor's ability to successfully reorganize.[xxvi] When the debtor is in the preliminary stages of its Chapter 11, the success of the debtor's reorganization is speculative. Generally, to demonstrate a reasonable likelihood of success, a movant need only show the prospect or possibility that he or she will succeed and need not prove same with certainty.[xxvii] As such, debtors are afforded the opportunity to present a plan for consideration by all its creditors.[xxviii] In *Otero Mills*, the court determined an injunction was proper unless or until the debtor failed to file its plan within the required time or the plan was not approved.[xxix]

In assessing whether there is little to no harm to the other party or parties, courts look to the balance of the relative harm between the debtor and the non-debtor parties. Courts weigh such factors as the length of the time period of the stay, the constitutional or contractual issues at issue, and the financial impact to the creditor body as a whole.[xxx] Finally, courts also balance the public interest in a successful bankruptcy reorganization of the debtor versus other competing societal interests being asserted by the creditor. Courts implement injunctions when it is necessary or appropriate to preserve the going concern of the debtor or to maximize the property available to satisfy the claims of all creditors of the estate.

Injunctive Relief via a Settlement Agreement under §105(a):

Permanent injunctions (releases, bar orders, and channeling injunctions) are often bargained for conditions of settlement agreements where a party to the settlement is contributing significant funds, usually from insurance policies or non-exempt assets, in exchange for releases of third party claims against the settling party. In *Matter of Munford, Inc.*, 97 F. 3d 449, 452 (11th Cir. 1996), the 11th Circuit described the factors a bankruptcy court should assess when evaluating the appropriateness of a bar order when it is essential for a litigation settlement agreement. In *Munford*, the debtor filed for Chapter 11 bankruptcy after an unsuccessful leveraged buy-out.[xxxi] After commencing litigation against the valuation and consulting firm, as well as the former officers, directors, and shareholders, the parties eventually reached a settlement agreement, which contained a bar order permanently enjoining the non-settling defendants from pursuing claims against a third party.[xxxii] The settlement agreement provided $350,000 of the consulting firm's $400,000 liability insurance policy, setting aside $50,000 of the policy for attorney's fees.[xxxiii] However, the consulting firm conditioned the settlement offer upon the bankruptcy court's issuance of a protective order permanently enjoining the non-settling defendants from pursuing contribution or indemnification claims against the firm.[xxxiv] The bankruptcy court entered an order approving the settlement agreement and bar order, which the district court affirmed.[xxxv] On appeal, the non-settling defendants attacked the bankruptcy court's authority to approve the bar order.[xxxvi]

The 11th Circuit determined that bankruptcy courts, pursuant to 11 U.S.C. §105(a) and Federal Rules of Civil Procedure 16, can "enter bar orders where such orders are integral to settlement in an adversary proceeding."[xxxvii] The court also set forth factors that should be assessed to reasonably determine whether a bar order is fair and equitable, including: (i) "the interrelatedness of the claims that the bar order precludes"; (ii) "the likelihood of the non-settling defendants to prevail on the barred claim"; (iii) "the complexity of the litigation"; and (iv) "and the likelihood of depletion of the resources of the settling defendants."[xxxviii] The court concluded that the bar order was necessary because at least one of the parties "would not have entered into the settlement agreement" without it, and as such, it was "integral" to the settlement.[xxxix] Most importantly, the settlement agreement provided the estate and its creditors with the majority of the firm's insurance policy. Without the settlement, the insurance policy would have been depleted by litigation costs and the debtor could have been left without means to collect on a judgment. In this case, the bar order was necessary to maximize the property available to satisfy the claims of all creditors of the estate.

Injunctive Relief via a Plan of Reorganization under §105(a):

After *Munford*, the 11th Circuit addressed the factors a bankruptcy court should assess when evaluating the appropriateness of a bar order when it is an integral part of a reorganization plan. *In re Seaside Engineering & Surveying, Inc.*, 780 F.3d 1070, 1079 (11th Cir. 2015). In *Seaside*, an engineering firm filed for Chapter 11 bankruptcy and submitted a reorganization plan which proposed that the firm reorganize and continue operations under a new name.[xl] The plan also included a bar order that prohibited lawsuits against the company (pre- or post-reorganization) and the company's officers related to or arising out of the bankruptcy.[xli] The bankruptcy court approved the settlement containing the bar order.[xlii] One interested party, a creditor, appealed the approval of the bar order. The district court affirmed, and the creditor appealed to the 11th Circuit.[xliii]

The court held that bar orders should not be issued lightly but only after a fact intensive inquiry and should be reserved for those unusual cases in which the bar order is necessary for the success of the reorganization, and only in situations in which such order is fair and equitable under all the facts and circumstances.[xliv] The 11th Circuit specifically adopted the seven-factor test set forth by the Sixth Circuit in *In re Dow Corning Corp.*, 280 F. 3d 648, 658 (6th Cir. 2002):

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

The 11th Circuit also held that bankruptcy courts should have discretion to determine which of the *Dow Corning* factors will be relevant in each case.[xlv] These factors should be considered a nonexclusive list of considerations, and should be applied flexibly, always keeping in mind that such bar orders should be used "cautiously and infrequently," and only where essential, fair, and equitable.[xlvi] Upon reviewing the bankruptcy courts' application of the *Dow Corning* factors, the court agreed that the releases prevented claims against non-debtors that would undermine the operations of, and doom the possibility of success for, the reorganized entity. With respect to the *Dow Corning* and *Munford* factors, the court noted: (i) the reorganized debtor would deplete its assets continuing to defend the voluminous litigation, key employees would expend their time defending litigation as opposed to focusing on professional duties, and without the release it was doubtful that the engineers and surveyors would be able to perform their work, complete contracts and create receivables necessary for the life blood of the reorganized debtor; (ii) the plan provided for the payment in full, or substantially in full, of the class or classes affected by the injunction; and (iii) the release was narrowly limited in scope to claims arising out of the Chapter 11case, and did not include claims arising out of fraud, gross negligence, or willful misconduct.[xlvii]

The court concluded by noting that the plan benefits more than the debtor's insiders, but also the non-shareholder employees who will retain their jobs, the creditors that receive compensation over time, and the Corps of Engineers that will continue to receive engineering services. The plan and the injunction accomplished the goals of Chapter 11 by preserving the going concern of the debtor and maximizing the assets available to satisfy creditors. On balance the public interest was served by preserving jobs in the community, allowing the business to continue to operate instead of liquidation, and achieving a consensual resolution amongst the debtor and its creditors.

Could *Purdue Pharma* Erase 40 years of Precedent?

In the past three years, *Purdue Pharma* has garnered much attention and negative publicity on the use of injunctions in bankruptcy proceedings as an improper vehicle to shield third parties from liability. In response to public sentiment, on March 19, 2021, Representative Carolyn Maloney from New York introduced H.R. 2096, the Stop shielding Assets from Corporate Known Liability by Eliminating non-debtor Releases Act or the SACKLER Act which would prohibit a bankruptcy court from releasing claims against non-debtors brought by states, tribes, municipalities, or the federal government.[xlviii] However, the bankruptcy court would be able to issue a stay not exceeding 90 days regarding such a claim. The SACKLER Act has been pending before the House of Representatives Judiciary Committee since October 19, 2021, and no further action has been taken. Despite the lack of legislative progress, there remains concern over the use and viability of injunctions being used to shield non-debtors from liability of third party *non-derivative* claims.

However, the injunctions described above (releases, bar orders, and channeling injunctions) each of which was approved by the 11th Circuit and federal courts in Florida, are distinct from the non-consensual releases of third parties in *Purdue Pharma*. The injunction in *Purdue Pharma* involved extremely broad non-consensual releases of *non-derivative* claims which released all members of the Sackler families from liability for claims that have been brought against them personally by third parties which arise out of a separate and independent duty that is imposed by statute on individuals who, by virtue of their positions, personally participated in acts of corporate fraud, misrepresentation and/or willful misconduct (claims that are not derivative, but as to which the debtor's conduct is a legally relevant factor). In the 11th Circuit, injunctions are narrowly tailored to release third party *derivative* claims against non-debtors. Derivative claims are those claims which seek to recover from the estate indirectly "on the basis of [the debtor's] conduct," as opposed to the non-debtor's own conduct.[xlix] Derivative claims relate to the adjustment of the debtor-creditor relationship because they are claims which relate to an injury to the corporation. If the creditor's claim is one that a bankruptcy trustee could bring on behalf of the estate, then it is derivative.[l] For 40 years bankruptcy courts have been utilizing injunctions to implement the goals and purposes of Chapter 11 and serve the public interest and rebuild communities. Hopefully, the majority view will continue to prevail and one bad apple from New York will not spoil years of precedent and well-founded case law which benefits all parties in interest.

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[1] Purdue Pharma Inc. ("PPI"), Purdue Transdermal Technologies L.P., Purdue Pharma Manufacturing L.P., Purdue Pharmaceuticals L.P., Imbrium Therapeutics L.P., Adlon Therapeutics L.P., Greenfield BioVentures L.P., Seven Seas Hill Corp., Ophir Green Corp., Purdue Pharma of Puerto Rico, Avrio Health L.P., Purdue Pharmaceutical Products L.P., Purdue Neuroscience Company, Nayatt Cove Lifescience Inc., Button Land L.P., Rhodes Associates L.P., Paul Land Inc., Quidnick Land L.P., Rhodes Pharmaceuticals L.P., Rhodes Technologies, UDF LP, SVC Pharma LP, and SVC Pharma Inc. (together, "Purdue"). The *Purdue* bankruptcy cases are currently pending before the United States Bankruptcy Court for the Southern District of New York. The plan refers to the confirmed Chapter 11 bankruptcy plan of reorganization at Bankruptcy Docket Number 3726. (See Case No. 19-23649, Dkt. No. 3787).

[2] Appel, J. (Writer), Barthwell, A. (Writer), Carvell, T. (Writer), Hynes, L. (Writer), Iwinski, G. (Writer), Kramer, M. (Writer), O'Brien, D. (Writer), Oliver, J. (Writer), Parsons, O. (Writer), Redd, C. (Writer), Rothkopf, J. (Writer), Shackelford, C. (Writer), Silva, B. (Writer), Vali, S. (Writer), Vali, S. (Writer) & Pennolino, P. (Director), Werner, C. (Director). (2021, August 8). Sacklers (Season 8, Episode 20) [TV series episode]. In T. Carvell, J. Oliver, L. Stanton. J. Taylor, J. Tchaban, J. Thoday (Executive Producers), *Last Week Tonight with John Oliver*. Avalon Television; Partially Important Productions.

[iii] *In re Purdue Pharma, L.P. et al.,* 633 B.R. at 115.

[iv] *See id*.

[v] Three of the eleven circuits – the Fifth, Ninth, and Tenth – reject entirely the notion that a court can authorize non-debtor releases outside the asbestos context. *See In re Pacific Lumber Co.*, 584 F.3d 229, 252 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394, 1401-02 (9th Cir. 1995); *In re W. Real Estate Fund*, 922 F.2d 592, 600 (10th Cir. 1990). Those courts read § 524(e) as barring the granting of such relief due to Congress' use of the phrase "Notwithstanding the provisions of § 524(e)" in § 524(g) as creating an exception to an otherwise applicable rule. However, the majority of the circuits – the First, Second, Third, Fourth, Sixth, Seventh, Eleventh and D.C. – hold that such releases/injunctions are permissible, under certain circumstances. *See In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 292 (2d Cir.1992); *In re Continental Airlines*, 203 F.3d 203, 214 (3d Cir.2000); *In re A.H. Robins Co., Inc.*, 880 F.2d 694, 700–02 (4th Cir.1989); *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir.2002); *In*

re Specialty Equip. Cos., 3 F.3d 1043, 1047 (7th Cir.1993); *In re Airadigm Communications, Inc.*, 519 F.3d 640, 655–58 (7th Cir.2008); *In re Munford, Inc.*, 97 F.3d 449 (11th Cir.1996); *In re Monarch Life Ins. Co*., 65 F.3d 973, 984–85 (1st Cir.1995); and *In re AOV Industries*, 792 F.2d 1140, 1152 (D.C.Cir.1986).

[vi] *Local Loan Co. v. Hunt*, 292 U.S. 234, 240, 54 S.Ct. 695, 78 L.Ed. 1230 (1934). *See also In re Empire for Him, Inc.*, 1 F.3d 1156, 1160 (11th Cir.1993).

[vii] *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 453, 119 S.Ct. 1411, 143 L.Ed.2d 607 (1999); *see also In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 119 (3d Cir.2004).

[viii] *See Assoc. of St. Croix Condominium Owners v. St. Croix Hotel Corp.*, 682 F.2d 446, 448 (3d Cir.1982).

[ix] *See id*. at 999–1002 (relying on both the automatic stay provision and the bankruptcy court's equitable powers under 11 U.S.C. § 105).

[x] *See id*.

[xi] *See McCartney v. Integra Nat. Bank North*, 106 F.3d 506, 510 (3rd Cir.1997); *In re Lazarus Burman Assocs*., 161 B.R. 891, 899–900 (Bankr.E.D.N.Y.1993) (enjoining guaranty actions against non-debtor principals of debtor partnerships because principals were the only persons who could effectively formulate, fund, and carry out debtors' plans of reorganization); *In re Steven P. Nelson*, 140 B.R. 814, 816–17 (Bankr.M.D.Fla.1992) (enjoining actions against non-debtor guarantor of debtor corporation's obligations where guarantor was the president of the debtor and the president's services, expertise and attention were essential to the reorganization of the debtor).

[xii] *Dunn v. Air Line Pilots Ass'n*, 836 F. Supp. 1574, 1584 (S.D. Fla. 1993).

[xiii] *See id*.

[xiv] *Peterson v. Avantair, Inc.,* 2013 WL 4506414, at *2 (M.D. Fla. Aug. 23, 2013); *SCI Northbay Commerce Fund 4, LLC v. SCI Real Estate Investments*, 2011 WL 1133898, at *1 (M.D. Fla. Mar. 28, 2011).

[xv] *Kreisler v. Goldberg*, 478 F.3d 209, 215 (4th Cir. 2007).

[xvi] *In re Philadelphia Newspapers, LLC*, 423 B.R. 98, 105 (E.D. Pa. 2010).

[xvii] *Fed. R. Bankr.P*. 7001(7), 7065; *In re Swallen's Inc.*, 205 B.R. 879, 880 (Bankr.S.D.Ohio 1997) (injunctive relief was denied for failure to request it through adversary proceeding); *In re Nasco P.R., Inc.*, 117 B.R. 35, 38 (Bankr.D.P.R.1990) ("A party wising to invoke the Court's injunctive power under Section 105(a) must file an adversary proceeding ... and must follow the traditional standards for the issuance of an injunction.").

[xviii] *Matter of Electronic Theatre Restaurants Corp.*, 53 B.R. 458 (N.D.Ohio 1985); *See also A.H. Robins*, 788 F.2d at 1008.

[xix] *See id*.

[xx] *See id* at 779.

[xxi] *Winter v. Natural Resources Defense Council, Inc.*, 555 U.S. 7, 129 S.Ct. 365, 172 L.Ed.2d 249 (2008).

[xxii] *See In re Otero Mills, Inc.*, 21, B.R. at 779.

[xxiii]*See id*.

[xxiv] *See id*.

[xxv] *See id*.

[xxvi] *See id.*

[xxvii] *See Conestoga Wood Specialties Corp. v. Sec'y of U.S. Dep't of Health & Human Servs.*, 724 F.3d 377 (3d Cir. 2013).

[xxviii] *See In re Otero Mills, Inc.*, 21, B.R. at 779.

[xxix] *See id*.

[xxx] See *In re Philadelphia Newspapers, LLC*, 407 B.R. 606, 617 (E.D. Pa. 2009); *In re LTL Management, LLC*, 2022 WL 586161, *19 (Bankr. D.N.J. 2022).

[xxxi] *See id.*

[xxxii] *See id*.

[xxxiii] *See id*.

[xxxiv] *See id*.

[xxxv] *See id*.

[xxxvi] *See id* at 452-53.

[xxxvii] *See id* at 455.

[xxxviii] *See id*.

[xxxix] *See id*.

[xl] *See id*. at 1075.
[xli] *See id*.
[xlii] *See id*.
[xliii] *See id* at 1075-76.
[xliv] *See id* at 1078.
[xlv] *See id* at 1079.
[xlvi] *See id*.
[xlvii] *See id at 1080-1081.*
[xlviii] H.R.2096 - 117th Congress (2021-2022): SACKLER Act, H.R.2096, 117th Cong. (2021), http://www.congress.gov/.
[xlix] *See In re Johns-Manville Corp.*, 517 F.3d 52, 62 (2d Cir. 2008).
[l] *In re Bernard L. Madoff Inv. Securities LLC*, 740 F.3d 81, 88 (2d Cir. 2014).

Faculty

Paul J. Battista is a partner with Venable LLP in Miami, where he focuses his practice on complex commercial bankruptcy, financial restructuring and insolvency matters, both in and out of court, including bankruptcy-related litigation and transactional work. He regularly represents chapter 11 debtors in possession (DIP), creditors' committees, DIP lenders, purchasers of assets and trustees in large and complex restructurings, workouts, and bankruptcy and insolvency proceedings in Florida and throughout the U.S. Through his representations, Mr. Battista has gained significant bankruptcy- and insolvency-related experience in numerous types of businesses, and has been involved in most of the large bankruptcy cases filed in the Southern District of Florida and statewide. He also has developed substantial experience in the representation of franchisors in numerous franchisee bankruptcies around the country, and he has experience in litigating a wide variety of bankruptcy-related claims and issues at both the trial and appellate levels, including fraud claims, Ponzi schemes, professional negligence, bankruptcy avoidance actions and collection of judgments. As a complement to his bankruptcy and creditors' rights practice, Mr. Battista has represented lenders and borrowers in all aspects of secured lending. His background includes the representation of one of the nation's largest investment banking houses in the secondary mortgage market. Mr. Battista is admitted to practice in Florida, Rhode Island and Massachusetts, and before the U.S. Court of Appeals for the Eleventh Circuit, the U.S. District Courts for the Southern and Middle Districts of Florida, and the U.S. Supreme Court. He is a Fellow in the American College of Bankruptcy and a *Chambers USA* Star Individual for 2022, and he has received Lawyer of the Year honors several times in *The Best Lawyers in America*. Mr. Battista is AV-rated by Martindale-Hubbell. He received his B.S. *magna cum laude* in accounting in 1983 from the University of Rhode Island and his J.D. *magna cum laude* in 1986 from Boston University School of Law.

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

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Leanne M. Prendergast is a partner with FisherBroyles, LLP in Jacksonville, Fla., and has more than 20 years of experience in commercial litigation and bankruptcy. She represents creditors, debtors, trustees, receivers and assignees at the trial and appellate levels. Ms. Prendergast practices in state and federal courts throughout Florida. She has earned the designation Certified E-Discovery Specialist from the Association of Certified E-Discovery Specialists and is a member of Women in E-Discovery. Ms. Prendergast is active in the International Women's Insolvency & Restructuring Confederation (IWIRC) and is its immediate past chair of the Florida Board, as well as a four-time delegate to IWIRC's Annual International Leadership Conference. In 2016, she was recognized as an Unsung Shero by the Women's Center of Jacksonville. Ms. Prendergast received her J.D. from the University of Florida College of Law.

Brian G. Rich is a partner with Berger Singerman LLP in Tallahassee, Fla., and leads complex chapter 11 negotiations and out-of-court reorganizations. He has overseen numerous large-scale cases with claims ranging from $100 million to over $1.5 billion. Mr. Rich represents bankruptcy trustees in fraud-related cases where he fights for victims of Ponzi schemes and rampant real estate fraud. He also advises real estate developers in real estate workouts and restructurings and represents clients seeking to purchase assets from troubled entities and loan portfolios. During the most recent economic crisis, Mr. Rich devoted a substantial portion of his practice to representing developers and borrowers in out-of-court restructuring matters throughout Florida, which included loan negotiations, deeds-in-lieu of foreclosure and settlements of guarantee claims. He received his B.S. in business administration with a concentration in finance from Temple University and his J.D. from the University of Miami School of Law.

R. Scott Shuker is a bankruptcy partner with Shuker & Dorris, P.A. in Orlando, Fla., and practices primarily in the areas of bankruptcy and creditors' rights. He has represented corporate debtors, secured and unsecured creditors, asset-purchasers and trustees in bankruptcy cases of corporate and individual debtors. He also has represented several chapter 11 trustees in Ponzi scheme cases and has experience in fraudulent-transfer litigation. Prior to entering law school, Mr. Shuker was a corporate banking officer for Southeast Bank, N.A. He is Board Certified in Business Bankruptcy Law by the American Board of Certification, was named the 2010 Bankruptcy Lawyer of the Year (Orlando) by *The Best Lawyers in America* and ranked as a top bankruptcy attorney by *Chambers USA* for over 10 years. His notable representations include as debtor's attorney in the chapter 11 reorganization cases of Planet Hollywood International, Inc., Transit Group, Celebrity Resorts, Appliance Direct, Hudson's Furniture, FoodFirst Global Restaurants, Inc., DM World Transportation, Inc. and 1069 Restaurant Group, LLC. A Fellow in the Litigation Counsel of America, Mr. Shuker received his B.S. in finance in 1986 with high distinction from Pennsylvania State University and his J.D. with high honors in 1993 from the University of Florida College of Law, where he was a member of the Order of the Coif.