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Third-Party Releases: *The Landscape, Where We Stand, and the Path Forward*

August 30, 2022

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The Landscape

Landscape, Max Weyl, Smithsonian American Art Museum, Gift of Laura Dreyfus Barney and Natalie Clifford Barney in memory of their mother, Alice Pike Barney (n.d.) (Smithsonian Open Access Media (CC0) (*available at*: https://www.si.edu/object/landscape:saam_1952.13.161))

Introduction

Chapter 11 plans almost always include discharge, release, and exculpation provisions. To understand the state of play around "third-party releases," it's important to consider such provisions in the context of the other discharge, release, and exculpation provisions usually included in a chapter 11 plan.

Type of Provision	Description	Legal Basis
Discharge	The Debtor receives a "discharge" of all "claims" and "interests" in exchange for the treatment of such claims and interests under a confirmed chapter 11 plan of reorganization*	11 U.S.C. § 1141(d)
Debtor Release	The Debtor can release any claims it has against anyone in the world, as long as the **evidentiary record** supports such a release (i.e., the Debtors have looked at the potential claims being released and decided, in their business judgment, that they are not releasing anything of value and/or are getting sufficient consideration back from those benefiting from the release).	11 U.S.C. § 105(a) Fed. R. Bankr. P. 9019
Exculpation	A release of certain claims by both the debtor and non-debtor third parties of claims against professionals and other fiduciaries of the bankruptcy estate, termed an "exculpation." An exculpation is unique from estate releases and third-party releases because it provides qualified immunity to committee members and other estate professionals for actions taken **within** a Chapter 11 restructuring but specifically excludes claims based on gross negligence or willful misconduct.	11 U.S.C. § 105(a) 11 U.S.C. § 1123
Third-Party Release (Consensual)	Non-debtors consensually release claims they may have against other non-debtors.	11 U.S.C. § 105(a) 11 U.S.C. § 1123
Third-Party Release (Non-Consensual)	Non-debtors release claims they may have against other non-debtors without their consent and even if they object to such releases.	11 U.S.C. § 105(a) 11 U.S.C. § 524(g) (asbestos only)

*Does not apply when the chapter 11 plan is a plan of liquidation. In that circumstance, the debtor entities are dissolved, and all claims are usually channeled to a liquidating trust.

Consensual Third-Party Releases

Consensual third-party releases are relatively commonplace. However, a conflict may arise with respect to what constitutes sufficient "consent" with respect to third-party releases. Forms of purported consent other than "opt-in" are subject to conflicting views of courts in evolving case law.

Most Lenient ⟷ **Most Strict**

Notice and Opportunity to Object	"Opt-Out" Forms	"Opt-In" Forms
The non-debtor claimant will be deemed to consent to and be bound by the release provisions if provided with proper notice and given the opportunity to file an objection to the release provisions contained in the chapter 11 plan.	The non-debtor claimant will receive notice and a form that must be completed and returned manifesting the party's intent to "opt-out" of the third-party release. If the form is not returned, the non-debtor claimant will be deemed to have consented to the release by its silence and will be bound by it. *An "opt-out" mechanism may apply to only voting creditors, those deemed to reject, or more broadly to anyone.*	The non-debtor claimant will receive notice and a form to "opt-in" to the release. Unless the form is returned and marked expressly to opt-in to the release, the non-debtor claimant will **not** be bound by the release provisions.

Non-Consensual Third-Party Releases

Non-consensual third-party releases may be available in the majority of (but not all) jurisdictions, but only if justified by the unique facts and circumstances of the case.

Jurisdictions	Allowed / Not Allowed	Standard / Reasoning
Second Circuit Third Circuit Fourth Circuit Sixth Circuit Seventh Circuit Eleventh Circuit	Allowed	*Dow Corning* / *Master Mortgage* factors to justify a non-consensual third-party release: • an identity of interest between the debtor and the third-party benefitting from the release; • substantial contribution by the third-party; • the release must be essential to the reorganization and hinge on the debtor being free from indirect lawsuits against parties who have indemnity or contribution claims against the debtor; • the impacted class must vote overwhelmingly to accept the plan; • the plan must have a mechanism for paying all or a substantial portion of the claims in the classes affected by the release; • the plan must provide an opportunity for claimants who choose not to settle to recover in full (*Dow Corning* only); and • factual findings by the court must support its conclusion.
Fifth Circuit Tenth Circuit	Not Allowed	Non-consensual third-party release provisions conflict with § 524(e) of the Bankruptcy Code, which states that the "discharge of a debt of the debtor does not affect the liability of any other entity on . . . such debt."
Ninth Circuit	Evolving	Recently approved a non-consensual third-party exculpation clause that covered only "closely involved" parties and was limited to acts and omissions arising out of the chapter 11 cases, but also explicitly noted that its holding did not permit sweeping global releases of third parties in accordance with Ninth Circuit law. *Blixseth v. Credit Suisse*, 961 F.3d 1074, 1085 (9th Cir. 2020).

Non-Consensual Third-Party Releases (Cont'd)

Recently, the Third Circuit Court of Appeals held that a bankruptcy court has sufficient adjudicative authority to approve and enforce third-party release provisions under the Supreme Court's decision in *Stern* v. *Marshall*.

Stern v. *Marshall*, 564 U.S. 462 (2011)	A bankruptcy court lacks Article III judicial power to enter a final judgment on a state law counterclaim that is not otherwise resolved in the process of ruling on a creditor's proof of claim.
In re Millennium Lab Holdings II, LLC, 945 F.3d 126, 133-140 (3d Cir. 2019)	The bankruptcy court had the constitutional authority to enter a final order confirming a plan containing non-debtor third-party releases because plan confirmation is a matter "integral to the restructuring of the debtor-creditor relationship," and arguments that the release provisions violated the Bankruptcy Code were equitably moot. (*As discussed below, not all courts agree—see, e.g.*, *Purdue*, *Ascena*.)

Type of Jurisdiction	Description	Examples
Core	• "Arising in" a bankruptcy case • "Arising under" the Bankruptcy Code	• Interpretation of the scope of section 363(f) of the Bankruptcy Code "arises under" the Bankruptcy Code • The propriety of sale procedures for a 363 sale "arises in" a bankruptcy case
Non-Core	• Anything "related to" a bankruptcy case → could have "any conceivable effect" (the widely-adopted *Pacor* test) on the bankruptcy estate • Bankruptcy court may not enter a final judgment on non-core claims, but rather must submit proposed findings of fact and conclusions of law to the district court, which then must review such findings and conclusions *de novo*	• A common state law claim that a debtor has against a third-party, such as a lawsuit against a director of a debtor corporation for breach of fiduciary duties • Claims of non-debtor third-parties against other non-debtor third-parties that could have any conceivable effect on the bankruptcy estate (*but see Millennium*)

Where We Stand

Gathering Storm, Albert Bierstadt, Hirshhorn Museum and Sculpture Garden, Smithsonian Institution, Washington, DC, Gift of Joseph H. Hirshhorn (c. 1857-1858) (Smithsonian Open Access Media (CC0) (*available at*: https://www.si.edu/object/gathering-storm:hmsg_66.503))

PURDUE PHARMA

"There is a long-standing conflict among the Circuits that have ruled on the question, which gives rise to the anomaly that whether a bankruptcy court can bar third parties from asserting non-derivative claims against a non-debtor – a matter that surely ought to be uniform throughout the country – is entirely a function of where the debtor files for bankruptcy."

Judge Colleen McMahon, *In re Purdue Pharma, L.P.*

Purdue Pharma: The Bankruptcy Case and Plan Confirmation

- *Purdue's Bankruptcy Case and Plan Confirmation*
  - Purdue Pharma L.P. and its affiliates (collectively, "***Purdue***") filed for chapter 11 on September 15, 2019, in the Bankruptcy Court for the Southern District of New York.
  - Purdue sought to implement a settlement among Purdue, the Sackler family (the owners of Purdue), 24 state attorneys general and analogous officials from five U.S. territories, and other stakeholders involved in the opioid crisis multidistrict litigation in which Purdue was a defendant.
  - The settlement framework included, among other things, using the bankruptcy process to *non-consensually* release all third-party non-debtor claims against the Sackler family in exchange for their contribution to the settlement.
  - Purdue proposed a plan that included the funding of $4.325 billion from the Sackler family in exchange for the comprehensive resolution of both private and public claims against the Sackler family—including claims premised on their alleged fraud, misrepresentation, and willful misconduct.
  - Various stakeholders objected to the plan, many of whom challenged the legality of the Sackler releases.
  - In a ruling from the bench on September 1, 2021 and filed on the docket on September 17, 2021, Judge Drain confirmed Purdue's plan, including the non-consensual third-party releases, but required that the releases be limited to claims in which "a [d]ebtor's conduct, or a claim asserted against the [d]ebtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the shareholder released party." *See In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021).

Purdue Pharma: The District Court Appeal

- *Appeal of the Purdue Confirmation Order to the S.D.N.Y. District Court*
  - Certain parties who objected to Purdue's plan appealed the confirmation order to the United States District Court for the Southern District of New York.
  - At issue on appeal was whether a bankruptcy court is statutorily authorized to grant non-consensual releases of direct claims against non-debtors held by third parties (outside of the asbestos mass tort context (which is subject to a statutory exception in § 524)).
  - District Judge McMahon considered the issue and rendered her opinion on December 16, 2021 in *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021), vacating Judge Drain's confirmation order, pertinently determining that:
    - (i) the Bankruptcy Court lacked constitutional authority under *Stern* to enter a final order approving the non-consensual third-party releases, even though they were incorporated in a proposed plan, because the third-party claims against non-debtors do not stem from the bankruptcy and would not necessarily be resolved in the claims-resolution process, but (ii) the Bankruptcy Court did have "related to" subject matter jurisdiction to approve the release of claims against non-debtors, and
    - The Bankruptcy Code does not authorize a bankruptcy court to order the non-consensual release of non-derivative third-party claims against non-debtors in connection with confirmation of a chapter 11 plan.

Purdue Pharma: The District Court Appeal (cont'd)

- Prior to this opinion being rendered, it had been widely assumed that the Second Circuit was a jurisdiction that permitted non-consensual third-party releases based on seminal cases such as *Drexel* and *Metromedia*. However, after a careful and thorough discussion of the leading cases and their procedural and historical context, Judge McMahon concluded that the Second Circuit had not spoken directly on the issue:
  - The *Purdue* district court determined that *In re Drexel Burnham Lambert, Grp., Inc.*, 960 F.2d 285 (2d Cir. 1992), carried no precedential value in determining whether the court had statutory authority to approve the releases in part because: (1) the *Drexel* court never identified a statutory source of power that grants a bankruptcy court the authority to enjoin claims and (2) *Drexel* was decided two years before Congress passed sections 524(g) and (h).
  - The *Purdue* district court further determined that reliance on *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 138 (2d Cir. 2005), was inappropriate because the *Metromedia* Court did not actually conclude that such releases were consistent with or authorized by the Bankruptcy Code. The court distilled the guidance from *Metromedia* as follows: "because statutory authority is questionable and such releases can be abused, they should be granted sparingly and only in 'unique' cases." But the court found that: "This will no longer do. Either statutory authority exists or it does not. There is no principled basis for acting on questionable authority in 'rare' or 'unique' cases, especially as the United States Supreme Court has recently held that there is no 'rare case' rule in bankruptcy that allows a court to trump the Bankruptcy Code." (citing *Czyzewski v. Jevic Holding Corp.*, 137 S.Ct. 973, 986 (2017)).

Purdue Pharma: The District Court Appeal (cont'd)

- Judge McMahon undertook a thorough statutory analysis to determine whether non-debtor third-party releases are authorized under the Bankruptcy Code. She considered whether any statutes provide (a) express authority, (b) implied authority, or (c) residual authority.
- In considering whether the Bankruptcy Code provided express authority for the releases, the court considered whether the Bankruptcy Code sections cited by the Bankruptcy Court expressly authorized the releases and found they did not.
  - Section 1123(b)(6) provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title." The court determined by analogy that because section 105(a) does not confer any substantive authority on the Bankruptcy Court, section 1123(b)(6) cannot be read to confer such authority either. In addition, the release is inconsistent with section 523, which ensures that fraud claims not be discharged.
  - Section 1123(a)(5) provides that a plan shall "provide adequate means for the plan's implementation" and lists various types of provisions that could be included to satisfy that requirement (which list does *not* include releases of any kind). The court determined that the release of claims against non-debtors falls outside the scope of section 1123(a)(5) and that section 1123(a)(5) does not authorize a bankruptcy court to approve something simply because doing so would ensure funding for a plan, explaining: "[T]he mere fact that the money is being used to fund implementation of the plan does [not] give a bankruptcy court statutory authority to enter an otherwise impermissible order in order to obtain that funding."
  - Section 1129(a)(1) requires that a plan comply with the applicable provisions of title 11 in order to be confirmed. The court found this provision to be too general to confer substantive authority required to invoke another highly general provision like section 105(a).

Purdue Pharma: The District Court Appeal (cont'd)

- In considering whether the Bankruptcy Code provided implied authority for the releases, the District Court considered and rejected the Debtors' argument that the requisite statutory authority could be inferred from the lack of any statutory prohibition, determining that:
  - Inferring authority from silence is inconsistent with the notion that the Bankruptcy Code is a ***comprehensive*** federal system that governs "the orderly conduct of debtors' affairs and creditors' rights";
  - Congress ***has*** spoken on the subject of non-debtor releases where it wanted to in section 524(g) and (h) (which permits non-debtor third-party releases of certain third-party claims against certain non-debtors for direct or indirect liability for claims against the debtor, exclusively in the context of *asbestos* bankruptcy cases) to preempt the field where non-debtor releases were concerned; and
  - Applying general provisions (*e.g.*, sections 105(a) and 1123(a)(5) and (b)(6)) to justify expanding the express authority conferred by Congress under section 524(g) to a situation that is *not comprehended by that statute* violates principles of statutory construction, which require that specific provisions govern over general provisions.
- In considering whether the Bankruptcy Code provided residual authority for the releases, the District Court considered Bankruptcy Code section 105, which provides that a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title, and concluded that there is nothing in the Bankruptcy Code that specifically authorizes these releases, not even in order to achieve even a purportedly noble bankruptcy objective. Any such residual authority of bankruptcy courts cannot be exercised in contravention of specific provisions of the Bankruptcy Code.

Purdue Pharma: Further Mediation, Settlement, and Second Circuit Appeal

- *Further Mediation and Settlement Following the District Court Ruling*
  - Almost three months after Judge McMahon's ruling vacating the *Purdue* confirmation order and invalidating the third-party releases in it, on March 3, 2022, the objectors and the Sackler family reached a deal in mediation before District Judge Chapman, whereby the objectors agreed to be consensually bound by the third-party releases in Purdue's plan, and, in exchange, the Sacklers agreed to contribute an additional $1.175 billion in cash in settlement payments to the Plan.
  - Judge Drain approved the settlement term sheet on March 10, 2022. Under that term sheet, the objectors agreed to withdraw their opposition to the appeal of the District Court decision. The agreement is conditioned entirely on one or more orders from the District Court or the Second Circuit allowing for consummation of the Plan.
- *Appeal to the Second Circuit*
  - As will be discussed below, despite this further settlement, the United States Trustee ("UST") and certain Canadian creditors have continued to take the position that the third-party releases are improper and argued that position on appeal on April 29, 2022 before the Second Circuit, where a ruling has yet to be issued.

Post-*Purdue*: *Stoneway* and *LATAM*

- *Subsequent Rulings from S.D.N.Y. Bankruptcy Court*
  - *In re Stoneway Capital Ltd., et al.*, Case No. 1:21-bk-10646 (Bankr. S.D.N.Y. May 11, 2022)
    - In a virtual bench ruling, after nearly a week of deliberations, Judge Garrity approved a chapter 11 plan for an Argentine power plant owner containing opt-out third-party releases.
      - The UST opposed the third-party releases, arguing that the releases would extinguish claims against non-debtors without affirmative consent of the releasing creditors (in conflict with *Purdue Pharma*).
      - However, the court determined that creditors whose claims were being released had more than sufficient notice to allow them to opt-out of the third-party releases where the releases and how to opt out of them were "conspicuously disclosed in boldface type" on every ballot, and where the releases were "integral" to the plan and were the product of good faith negotiations in which the released parties contributed "valuable consideration" to the plan.
  - *In re LATAM Airlines Group S.A.*, 2022 WL 2206829, at *45 (Bankr. S.D.N.Y. June 18, 2022)
    - Judge Garrity approved opt-out non-debtor third-party releases in the chapter 11 plan of a Latin American airline.
      - The UST and certain creditors argued that an opt-in procedure was required for sufficient consent to be given.
      - However, the court approved the third-party releases with an opt-out mechanism pursuant to which voting creditors could opt-out on their ballots and non-voting creditors could opt-out as provided in the notice of non-voting status they received, where a clear and prominent explanation of the opt-out procedure had been provided and where instrumental contributions to the restructuring had been made by the released parties.

PATTERSON v. MAHWAH BERGEN RETAIL GROUP, INC.

"[T]he practice of regularly approving third-party releases and the related concerns about forum shopping call into question public confidence in the manner that these cases are being handled by the Bankruptcy Court in the Richmond Division."

Judge David J. Novak, *Patterson v. Mahwah Bergen Retail Group, Inc., f/k/a Ascena Retail Group, Inc.*

Mahwah Bergen (f/k/a Ascena): Bankruptcy Case and Plan Confirmation

- *Ascena's Bankruptcy Case and Plan Confirmation*
  - Ascena Retail Group, Inc. ("***Ascena***") (which owned various women's and girl's clothing brands, including Ann Taylor, LOFT, Lane Bryant, Catherine's, Justice, Lou & Grey, and Cacique), and certain of its subsidiaries filed chapter 11 cases on July 23, 2020, in the Bankruptcy Court for the Eastern District of Virginia.
  - Ascena ultimately liquidated after selling substantially all of its assets through a 363 sale for an aggregate price of $651.8 million.
  - The SEC, the UST, and the lead plaintiffs in a securities fraud action against Ascena and two of its former executives pending in the United States District Court for the District of New Jersey (the "***Securities Litigation***") objected to the confirmation of Ascena's plan. Some of the objections were resolved by the addition of disclosures in the disclosure statement, and others were overruled.
    - Specifically, the Securities Litigation lead plaintiffs and the UST objected to the third-party releases contained in the Plan. On February 25, 2021, the Bankruptcy Court confirmed Ascena's plan of liquidation over the objections.
    - The Securities Litigation lead plaintiffs also sought to opt out of the third-party releases in the Plan on behalf of the entire putative class, which the Bankruptcy Court denied.

Ascena: District Court Appeal

- *Appeal of the Ascena Confirmation Order to the E.D. Va. District Court*
  - The lead plaintiffs in the Securities Litigation and the UST appealed the confirmation order to the District Court for the Eastern District of Virginia.
  - The issues on appeal were whether the Bankruptcy Court erred: (a) by finding the opt-out third-party releases to be consensual and (b) in approving the broad third-party releases without applying the applicable seven-factor standard set forth by the Fourth Circuit in *Behrmann* (applying the Sixth Circuit test from *Dow Corning*).
  - The District Court rendered its opinion on January 13, 2022. *See* *Patterson v. Mahwah Bergen Retail Group, Inc.*, 636 B.R. 641 (E.D. Va. 2022).
  - As an initial matter, the District Court found that the Securities Litigation lead plaintiffs lacked standing to appeal the confirmation order with respect to the inclusion of non-debtor third-party releases because they had opted out of the releases and so those provisions of the Plan did not impact them. The Court also found that the lead plaintiffs also could not assert standing based on their representation of the putative class because the class had not been certified.
    - However, the Court found the UST had standing to raise the challenges to the third-party releases.

Ascena: District Court Appeal (cont'd)

- The District Court first determined that the Bankruptcy Court violated *Stern v. Marshall* by exceeding its constitutional authority in granting the third-party releases.
  - The Court found that the Bankruptcy Court failed to engage in any content-based analysis demanded by *Stern* regarding whether extinguishing each of the non-debtor third-party claims being released was an exercise of its core bankruptcy authority.
  - Because releasing the claims amounted to extinguishing of those claims, the releases amounted to adjudication of the claims for *Stern* purposes.
  - The Bankruptcy Court exceeded its constitutional authority by adjudicating the *Stern* claims without knowing and voluntary consent of the Releasing Parties.
  - "Due to the substantial constitutional issues at play with the use of th[e] perilous tool [of non-debtor third-party releases], it seems preferable for a bankruptcy court to submit any third-party releases to the district court for approval via a Report and Recommendation in the rare and exceptional case that warrants the use of third-party releases."

Ascena: District Court Appeal (cont'd)

- Whether the Bankruptcy Court erred in failing to apply *Behrmann*
  - The Court rejected the proposition that bankruptcy courts are categorically barred from approving non-consensual releases of third-party claims and instead adopted the Sixth Circuit's seven-factor test set forth in *In re Dow Corning Corp*., which has been adopted in the Fourth Circuit in *Behrmann*
  - The Court further found the Bankruptcy Court's approval of the non-consensual third-party releases was clear error of fact and law.
  - The Court explained that even if consent could obviate the need to comply with the *Behrmann* factors, consent must not be based on silence through an opt-out release mechanism in a plan. "Failure to opt out, without more, cannot form the basis of consent to the release of a claim."
  - Given the failure of consent to the third-party releases in this case, the District Court held that the Bankruptcy Court should have conducted a *Behrmann* analysis to determine whether the third-party releases could be approved.
    - *The Bankruptcy Court had concluded in a single footnote of its opinion that if the Behrmann factors were applicable, they would be satisfied for the reasons stated by Ascena in its confirmation brief.*

Ascena: District Court Appeal (cont'd)

- The *Dow Corning* factors, adopted by *Behrmann*:

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;

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

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

The impacted class, or classes, has overwhelmingly voted to accept the plan;

The plan provides a mechanism to pay for all, or substantially all, of the class or classes 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 support its conclusions.

Ascena: District Court Appeal (cont'd) and Remand

- The District Court concluded that none of the *Behrmann* factors were satisfied.
- The District Court further concluded that it could sever the non-debtor third-party releases from the Plan as they did not "form an integral part" of the Plan, and not severing them would be to let "gamesmanship occur." The court also explained that severing the releases would not upset the Plan, the negotiation of the releases was not arms-length as the Releasing Parties did not have a seat at the negotiating table, and no reason was given as to why the releases comprised a necessary part of the Plan.
- Additionally, the court declined to dismiss the appeal on equitable mootness grounds. "The Court will not apply the doctrine of equitable mootness against the Trustee when the Trustee seeks to protect the rights of absent individuals." Equity does not support immunizing plainly erroneous and unconstitutional release provisions from appellate review.

– Finally, the District Court also found that the Bankruptcy Court erred in approving the exculpation provision in the Plan as "overly broad," but remanded to permit redrafting of the exculpation provision to limit the scope of parties covered, where it "extend[ed] beyond fiduciaries who have performed necessary and valuable duties."

– Ascena's plan was reconfirmed on March 2, 2022, without the voided third-party releases and with a narrowed exculpation provision.

MALLINCKRODT

"I am also aware of recent rulings from courts in the Second and Fourth Circuit that hold otherwise . . . In this case, however, I am applying the law of the Third Circuit which has recognized that bankruptcy courts do have statutory and constitutional authority to approve a plan of reorganization that contains non-consensual third-party releases, *albeit*, only in extraordinary cases."

Judge John T. Dorsey, *In re Mallinckrodt PLC*

Mallinckrodt: Bankruptcy Filing and Plan

- *The Mallinckrodt Bankruptcy Filing and Plan*
  - Mallinckrodt and its debtor affiliates (the "***Debtors***") operate a global specialty biopharmaceutical company that produces and sells a variety of pharmaceutical products, including opioids. Prior to the filing of their bankruptcy cases, the Debtors faced numerous lawsuits in connection with their production of opioids, among others. To resolve the litigation, the Debtors negotiated principal terms of a number of settlements with respective stakeholders, and on October 12, 2020, filed chapter 11 bankruptcy cases to finalize and implement those settlements through the Plan.
  - The resulting chapter 11 Plan included four types of releases:
    - Releases by the Debtors;
    - Releases by non-debtor third party holders of certain claims and interests who were given the opportunity to opt-out of the third-party releases by way of ballots or an opt out form (the "***Opt-Out Third-Party Releases***");
    - Non-consensual releases by opioid claimants (the "***Non-Consensual Opioid Release***"); and
    - Releases by the Debtors and related parties of the opioid claimants.
  - The plan also included an exculpation provision that extended broadly to certain parties who were not estate fiduciaries and retroactively applied to the prepetition period (the "***Exculpation Provision***").

Mallinckrodt: Confirmation Objections

- *Objections to Certain Releases in the Plan*
  - The Plan, including the release and exculpation provisions, was generally supported by the creditor body, with the exception of one creditor (the state of Rhode Island), the UST, and the Securities and Exchange Commission (the "***SEC***"), who objected as follows:

	UST	SEC	Rhode Island
Opt-Out Third-Party Releases **Note: a Pension Trust also objected but was found to lack standing because it had opted out of the releases and so was not bound by them*	☑		☑
Non-Consensual Opioid Release	☑	☑	
Exculpation Provision	☑		

Mallinckrodt: Confirmation Objections (cont'd)

- Objections to Non-Consensual Opioid Releases:
  - The opioid claimants objected that they were not given the opportunity to opt out of the non-consensual third-party releases, but they were nonetheless bound by them.
  - Judge Dorsey considered the objections in a written opinion dated Feb. 8, 2022 and found that these releases were appropriate under the Third Circuit's standard in *In re Continental*, which requires that non-consensual third-party releases be (i) necessary to the reorganization and (ii) fair. *See* *In re Mallinckrodt PLC*, 639 B.R. 837 (Bankr. D. Del. Feb. 8, 2022).
    - **Necessity**: The Non-Consensual Opioid Releases were necessary to the Debtors' reorganization because they were an integral part of the settlements embodying them and would remove an existential threat to the Debtors' business while ensuring claimants would receive far in excess of what they would receive in continued litigation. The releases related to the massive number of lawsuits the Debtors face and were part of settlements that were the Debtors' "only way out." The releases were necessary because the entities and individuals are involved to such a degree with the Debtors' business that a suit against them is likely to be a drain on the Debtors.
    - **Fairness**: The Non-Consensual Opioid Releases were a fair result for opioid claimants because they were negotiated at arm's length with a large group of sophisticated parties representing diverse interests, and substantial consideration was being given in exchange for the releases. Additionally, the releases were fair because it is unlikely that there were material claims against the non-debtor released parties.
  - Judge Dorsey also considered the following additional factors: (a) the "extraordinary nature" of the "notorious and sensitive" case due to the real and immediate opioid pandemic, making time of the essence; (b) the Non-Consensual Opioid Releases were overwhelmingly supported by the creditor body; and (c) practically speaking, the alternative to the plan and the releases would be "protracted and expensive litigation."

Mallinckrodt: Confirmation Objections (cont'd)

- The UST had also argued that the court lacked authority to approve the releases because due process was not satisfied. Here, Debtors undertook a broad opioid noticing program to reach known and unknown opioid claimants, which included not only direct mail and other outreach to claimants and potential claimants (including those who filed proofs of claims in *Purdue*) but also included television broadcasting, print media, radio, and social media and other online locations, including a dedicated website. The court found the Debtors' noticing satisfied due process requirements because it was so extensive, because the committee competently represented the interests of opioid claimants and supported including the releases, and because opioid claims were channeled to a trust, including those of any future claimants (who were also represented by an FCR) who may not have received notice.

Mallinckrodt: Confirmation Objections (cont'd)

- Objections to Opt-Out Third-Party Releases:
  - Objectors argued that the opt-out third-party releases were not consensual because they released claims of shareholders who were deemed to reject and by unsecured creditors who were unimpaired or who did not return a ballot with the opt out box checked or otherwise submit an opt-out form; accordingly, they argued that the releases must satisfy the *Continental* requirements for non-consensual third-party releases.
  - Judge Dorsey stated that: "There can be no debate over the proposition that a bankruptcy court can approve a plan that includes third-party releases. The question is, what constitutes consent and can consent be inferred from failure to respond to a notice including an opt-out? In other words, can consent be inferred from silence or more accurately, the failure to act?"
  - Judge Dorsey concluded that the Opt-Out Third-Party Releases were consensual.
  - Judge Dorsey examined the extent of the notice of the Opt-Out Third-Party Releases and found ample evidence in the record that the Debtors made every effort to ensure that the releasing parties were sent notices in a variety of ways that clearly explained in "no uncertain terms" that action was required to preserve claims.
  - Judge Dorsey also found relevant that the fact that the plan contained the Opt-Out Third-Party Releases was well-known and all Non-Debtor Releasing Parties had "countless" opportunities to opt-out, and only one did.
  - Judge Dorsey did observe, however, that the use of opt-outs is not appropriate in every case and that courts (including the Delaware Bankruptcy Court) are divided on the issue. But he did make clear that "any creditor that claims that they did not receive notice of their right to opt out will have the opportunity to seek relief from the Court to exercise their rights."

Mallinckrodt: Confirmation Objections (cont'd)

- Objections to Exculpation Provision:
  - The UST had argued that the Exculpation Provision was impermissible because it extended temporally back to the prepetition period and because it was not limited to estate fiduciaries.
  - Judge Dorsey held that the Exculpation Provision was temporally overbroad and improperly swept in prepetition conduct, which exceeds the parameters of what the Bankruptcy Code permits—conduct that occurs between the petition date and the plan effective date. *See* 11 U.S.C. § § 1102, 1103.
  - He also held that the inclusion of the reorganized debtor and distribution agents—both non-estate fiduciaries—was improper because neither party has any role in the bankruptcy prior to the effective date. *Id.*
  - Accordingly, Judge Dorsey ordered the Debtors to submit a revised form of confirmation order with the exculpation provision modified consistent with his ruling.

After *Mallinckrodt: Gulf Coast Health Care*

- In *Gulf Coast Health Care LLC*, 1:21-bk-11336 (Bankr. D. Del.), on May 4, 2022 Judge Owens considered whether non-debtor third-party releases in a debtor's plan could be approved and declined to confirm the plan because she found the releases, which were part of a settlement among the debtors and their keys stakeholders, did not give tort creditors a large enough recovery to compensate for the third-party claims they would surrender.
- The court found that even though the debtor had shown that the Plan would provide better recovery for unsecured creditors than a liquidation, and it otherwise met the legal requirements for confirmation, the non-consensual non-debtor third-party releases for tort claimants could not be approved.
  - The tort claimants would receive compensation only for their direct claims against the debtor and not on account of the third-party claims being released, and there had been no analysis of what those claims were worth.
  - Critically, the plan also failed to get overwhelming creditor support (and creditor support is often the best evidence of the fairness of third-party releases to releasing parties). The tort claimant class voted to reject the plan 54-53, (including as a "no" vote a creditor's original ballot rejecting the plan despite a later "yes" vote purporting to change the creditor's vote that could not be counted without violating the disclosure statement order). Further, 52 of the 54 rejecting voters (and the UST) had also all filed unresolved objections to the plan's inclusion of the non-consensual non-debtor third-party releases.
  - The debtor also failed to satisfy the "exacting" requirements of *Continental* because it failed to establish that the releases to each of the released parties were necessary to the reorganization, fair to the creditors, and given in exchange for reasonable consideration.

After *Mallinckrodt: Boy Scouts of America*

- *The Boy Scouts of America ("BSA") Bankruptcy Filing and Plan*
  - BSA is a nationally-recognized nonprofit organization that "promote[s], through organization, and cooperation with other agencies, the ability of boys to do things for themselves and others, to train them in Scoutcraft, and to teach them patriotism, courage, self-reliance, and kindred virtues[.]"
  - To accomplish its mission, BSA relies on 250 Local Councils and tens of thousands Chartered Organizations to operate individual scout units at a local level. Prior to filing its bankruptcy cases, BSA, Local Councils, and Chartered Organizations were named co-defendants in hundreds of lawsuits in which certain plaintiffs alleged sexual abuse within the scouting ranks ("***Abuse Claims***") since at least 1920.
  - By October 19, 2020, BSA was a named defendant in approximately 275 lawsuits asserting sexual abuse. Furthermore, at the time, BSA was aware of 1400 other similar claims not yet the subject of lawsuits. From 2017–2019, BSA spent more than $150 million on legal and related professional fees and costs in addressing such Abuse Claims.
  - On October 18, 2020, seeking a competent forum to deal with BSA's litigation burden, BSA and its affiliate filed chapter 11 bankruptcy cases in the Bankruptcy Court for the District of Delaware.

After *Mallinckrodt: Boy Scouts of America (cont'd)*

- *The Boy Scouts of America ("BSA") Bankruptcy Filing and Plan (cont'd)*
  - The Plan proposes global resolution of Abuse Claims against the Debtors, Related Non-Debtor Entities, Local Councils, Contributing Chartered Organizations, Settling Insurance Companies, and their respective Representatives. The Plan is based on the establishment of a settlement trust with certain trust assets to be contributed to it for the benefit of holders of Abuse Claims.
  - The Plan contains three sets of releases (two of which were analyzed by the Court):
    - Non-consensual (and certain consensual) releases by holders of Abuse Claims relating to Scouting against Local Councils, Chartered Organizations, Settling Insurance Companies, and their respective Representatives (the "***Scouting-Related Releases***")
    - Consensual unobjected-to releases of claims held by the Debtors and their estates (which are not the subject of the Bankruptcy Court's analysis) (the "***Debtor Releases***")
    - 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, their estates, or assets, whereby certain holders of claims were given an opportunity to opt-out of the third-party releases by way of ballots (if in a voting class) or by objecting to the Plan (if in a non-voting class) (the "***Opt-Out Releases***") (collectively, the Opt-Out Releases and the Scouting-Related Releases, the "***Third-Party Releases***"). *The Opt-Out Releases were argued to be non-consensual by certain objectors, but were ultimately found to be consensual, as discussed below.*

After *Mallinckrodt: Boy Scouts of America (cont'd)*

- *Objections to the Non-Consensual Third-Party Releases*
  - Challenges to the Scouting-Related Releases
    - The Scouting-Related Releases were challenged by certain Direct Abuse Claimants and the UST on grounds that:
      - The Bankruptcy Court lacked subject matter jurisdiction to approve third-party releases and
      - The Scouting-Related Releases were not fair and necessary as required by Third Circuit precedent set forth in *In re Continental*.
    - Certain of the Direct Abuse Claimants objected solely to the third-party release of the Church of Jesus Christ of the Latter-Day Saints (the "***TCJC***") arguing that releases for sexual abuse claims that were not Abuse Claims (i.e., sexual abuse claims independent of sexual abuse within the scouting ranks) should not be approved.
  - Challenges to the Opt-Out Releases
    - The UST objected to the Opt-Out Releases and argued that the opt-out procedure did not result in consensual releases and violated due process rights.
      - The UST also objected to the releases given by twenty-two categories of persons related to releasing parties arguing that such parties would likely not have received adequate notice that they would be providing releases and that therefore such releases should not be approved.

After *Mallinckrodt: Boy Scouts of America (cont'd)*

- The Bankruptcy Court's Rulings on Objections
  - Judge Silverstein crafted a lengthy opinion addressing confirmation issues, including the propriety of the third-party releases in the Plan. *In re Boy Scouts of America and Delaware BSA, LLC*, 2022 WL 3030138 (Bankr. D. Del. July 29, 2022).
  - **Subject Matter Jurisdiction**
    - Judge Silverstein concluded that she had the requisite jurisdiction to approve the third-party releases.
      - "Arising in" jurisdiction existed because the proceeding was a confirmation hearing that "by its nature, and not the particular factual circumstances, could arise only in the context of a bankruptcy case."
      - "Related-to" jurisdiction for purposes of determining whether claims could be enjoined under a plan existed because of the high degree of interrelatedness, and thus identity of interest, between the Debtors and the released parties (including with respect to Local Councils and Chartered Organizations, both operationally and due to the shared insurance among them), which therefore satisfied the test of conceivable impact on the estate if such Abuse Claims were to be brought against the released parties.

After *Mallinckrodt*: Boy Scouts of America (cont'd)

- The Bankruptcy Court's Rulings on Objections (cont'd)
  - **The Scouting-Related Releases**
    - Judge Silverstein concluded the Scouting-Related Releases (except for releases of all abuse allegations against TCJC described in more detail below) were appropriate and permissible and found "there is statutory authority to grant the third-party non-consensual releases."
      - Statutory Authority: The Bankruptcy Court has the ability, in appropriate circumstances, to exercise its inherent equitable power consistent with sections 105(a), 1123(a)(5), and 1123(b)(6) of the Bankruptcy Code.
      - Third Circuit Precedent: Scouting-Related Releases satisfied the standard set forth in *In re Continental* because the releases were both fair and necessary to the reorganization. As to fairness:
        - The Plan is a 100% payment plan providing a mechanism for payment of all or substantially all Abuse Claims.
        - The Plan provided for a timely assessment and payment of Direct Abuse Claims and equal treatment across claimants who would be assessed under the Trust Distribution Procedures.
        - The Scouting-Related Releases were consistent with the way claimants historically sued and settled claims with BSA—as a group.
        - Direct Abuse Claimants, as a class, accepted the Plan by over 85% and given that there are 82,209 claimants, 85% represented an overwhelming acceptance.
        - Without the Plan, litigation would result in either a race to the courthouse by claimants or a BSA-only bankruptcy plan resulting in a pennies-only recovery.
        - Survivors testified that the inclusion of negotiated Youth Protections in the Plan was a critical piece of bringing them justice and obtaining their approval of the Plan.

After *Mallinckrodt: Boy Scouts of America (cont'd)*

- As to necessity:
  - The Scouting-Related Releases were necessary to the reorganization to confirm the Plan and to ensure that BSA's Scouting program continues.
  - The releases were the cornerstone of the Plan, which was premised on funding the Settlement Trust in full.
  - The releases made possible the inclusion in the trust of insurance assets worth up to another $4 billion plus, which can be accessed more quickly and definitively.
  - The undisputed evidence showed that without the releases for Local Councils and Chartered Organizations, BSA would likely to suffer a drop in membership resulting in a drop in revenue and putting into question BSA's ability to continue as a national organization
  - The Plan, supported by the Scouting-Related Releases, would minimize BSA's involvement and permit it to focus on its mission.

- However, Judge Silverstein did not approve all of the Scouting-Related Releases. She declined to approve the portion of the Scouting-Related Releases granted in favor of the TCJC for non-Abuse Claims. Recognizing that she may still have jurisdiction over such claims, she concluded that (i) it was unclear that the evidence supported the granting of the releases and (ii) the settlement providing for such releases stretched the releases too far as such releases would cover sexual abuse claims against TCJC that were unrelated to scouting.

After *Mallinckrodt: Boy Scouts of America (cont'd)*

- **The Opt-Out Releases**
  - The Bankruptcy Court sustained in part and overruled in part the objections lodged by the UST regarding the Opt-Out Releases.
  - The Plan provided that Releasing Claim Holders would release all Released Parties from any claims existing before the Effective Date of the Plan related to the Debtors, their estates, or assets.
  - To avoid providing a release: (a) a holder of a claim who votes on the Plan (for or against) must affirmatively opt-out by checking a box on the ballot, and (b) a holder of a claim in an unimpaired class must file an objection. However, no holder of a Claim in an Impaired Class under the Plan will be deemed to release claims to the extent such holder abstained from voting.
  - Judge Silverstein found that these opt-out releases were appropriate under the circumstances and that releasing claimants were not deprived of their due process rights.
    - She examined the extent of the notice of the Opt-Out Releases and found abundant evidence in the record that holders of claims received sufficient notice of the releases, which were prominently featured on the face of the ballot and in the disclosure statement, among other places, including in widely-disseminated published notices.
    - She also noted that 2,200 claimants opted out of the releases, which demonstrated that claimants were given meaningful notice. However, as to 22 categories of persons *related to* releasing parties that were also purported to provide releases, the Bankruptcy Court agreed with the UST's objection and declined to find that such related parties received notice and thus did not approve the Opt-Out Releases relating to those parties.

After *Mallinckrodt: Boy Scouts of America (cont'd)*

- Procedural Update: On August 12, 2022, the Debtors filed an amended Plan and proposed confirmation order, both of which have been modified in a manner consistent with the Opinion. The Debtors also filed a corresponding motion requesting to amend and supplement the findings of fact and conclusions of law in the Court's opinion by entry of the revised confirmation order approving the modified Plan. The hearing on the motion to amend the Plan is set for September 1, 2022.

VITRO S.A.B. DE C.V.

"This court holds that the Bankruptcy Code precludes non-consensual, non-debtor releases," and "a non-consensual, non-debtor release through a bankruptcy proceeding" has been "explicitly prohibited" by the Fifth Circuit Court of Appeals.

Judge Carolyn Dineen King, *Matter of Vitro S.A.B. de C.V.*

Fifth Circuit: Overview of Cases for Comparison Purposes

- The stance in the Fifth Circuit is generally that non-consensual non-debtor releases are not permitted, though consensual releases (with opt-out mechanisms) and certain exculpation protections have been approved by courts within the Fifth Circuit. The following cases provide an overview of the state of the law in this area in the Fifth Circuit.
  - *In re Highland Cap. Mgmt.*, L.P., Case No. 2022 WL 3571094 at *12 (Aug. 19, 2022, 5th Cir. 2022) ((1) holding that provision exculpating certain non-debtor third parties, with respect to claims arising on or after the petition date and relating to the chapter 11 case, could only include the debtor, the committee, committee members, and independent directors as "Protected Parties" in light of § 524(e)'s "statutory bar on nondebtor discharge," and expressly *striking* exculpation for various other parties involved in the case including estate and committee professionals, but (2) finding injunction and gatekeeping provision to be lawful where it required any enjoined party seeking to bring certain claims arising from or related to the chapter 11 case and plan administration against a protected party to first seek the bankruptcy court's approval of the claim as "colorable.").
  - *In re Vitro S.A.B. de C.V.*, 701 F.3d 1031, 1059, 1069 (5th Cir. 2012) (in the context of considering whether non-consensual third-party releases were available in a chapter 15 case, explaining that in the Fifth Circuit, such releases through a bankruptcy proceeding are generally not available, and stating that the Fifth Circuit has repeatedly and expressly prohibited such relief).
  - *In re Pacific Lumber Co.*, 584 F.3d 229, 251-52 (5th Cir. 2009) (in the context of a plan proposed by non-debtor proponents in which the debtor would be dissolved, striking exculpation clause, except with respect to the creditors' committee and its members, where the clause purported to protect certain non-debtor third parties (the reorganized debtor and non-debtor plan proponents and their officers, directors, professionals, members, agents, and employees; the committee; committee members and their professionals) from claims arising during the bankruptcy case because such provision is prohibited by § 524(e) and distinguishing the releases at issue from non-debtor releases granted by courts in other circuits where the cases involved global settlements of mass claims against debtors and co-liable parties with such mass claims channeled to a specific pool of assets).
  - *In re Zale Corp.*, 62 F.3d 746, 760-62 (5th Cir. 1995) (stating that "[s]ection 524 prohibits the discharge of debts of nondebtors" and therefore an injunction must be overturned if it "effectively discharges a nondebtor" and holding that the bankruptcy court lacked (1) jurisdiction to enjoin certain third-party claims against a non-debtor and (2) authority under § 105 to permanently enjoin third-party claims against a non-debtor).

Fifth Circuit: Overview of Cases for Comparison Purposes (cont'd)

- *In re N. Richland Hills Alamo, LLC*, 2022 WL 2975121, at *12-13 (Bankr. N.D. Tex. July 27, 2022) (approving *consensual* third-party release with opt-out mechanism where parties entitled to vote could opt-out by rejecting the plan and checking a box on their ballot and parties not entitled to vote could opt out by checking a box on a notice of non-voting status).
- *In re Fieldwood Energy LLC*, 2021 WL 2853151 (Bankr. S.D. Tex. June 25, 2021) (approving third-party releases where they were *consensual* because (1) "all parties to be bound by the Third-Party Release either (i) voted to accept the Plan or (ii) affirmatively agreed to be a Releasing Party" through an opt-out mechanism and (2) all claimants "were given due and adequate notice of the Third-Party Release and sufficient opportunity and instruction to vote to accept or reject the Plan").
- *In re Patriot Place, Ltd.*, 486 B.R. 773, 822 (Bankr. W.D. Tex. 2013) (determining that non-debtor releases and exculpations do not comply with Fifth Circuit precedent because "[t]he Fifth Circuit takes a very restrictive approach to non-debtor releases in bankruptcy cases. Quoting the most recent case from the Fifth Circuit on this subject [*Vitro*]*:* non-consensual, non-debtor releases in bankruptcy proceedings in this Circuit have been 'explicitly prohibited,' this circuit has 'firmly pronounced its opposition to such releases,' and the 'Bankruptcy Code precludes non-consensual, non-debtor releases.'").
- *In re Bigler LP*, 442 B.R. 537, 543-44, n.6 (Bankr. S.D. Tex. 2010) (explaining, *inter alia*, that despite the Fifth Circuit's position that third-party releases are not permitted to discharge non-debtor claims, such relief may be available under § 1123(b)(3)(A) where such releases satisfy the requirements of a valid settlement of claims under the Bankruptcy Code, including consent and consideration).
- *In re Pilgrim's Pride Corp.*, 2010 WL 200000, at *5 (Bankr. N.D. Tex. Jan. 14, 2010) (explaining that the court may not, over objection, approve through plan confirmation third-party protections other than those provided to committees, committee members, and committee professionals).

The Path Forward

A Windswept Road, Edith Loring Getchell, Smithsonian American Art Museum, Gift of Society of Etchers (n.d.) (Smithsonian Open Access Media (CC0) (*available at*: https://www.si.edu/object/windswept-road:saam_1935.13.106))

Public Scrutiny

- It is uncommon for bankruptcy issues to interest broad public audiences, but third-party releases have recently come under increased public scrutiny. The following are some examples:
  - In the fall of 2021, on *Last Week Tonight with John Oliver* on HBO, John Oliver railed against the non-debtor third-party releases of the Sacklers and hundreds of companies and trusts in the *Purdue* case (prior to Judge McMahon overruling Judge Drain's confirmation order) and also complained that venue shopping that was occurring based on which jurisdiction would likely approve third-party releases.
    Available at: https://www.youtube.com/watch?v=uaCaIhfETsM
  - A recent episode of *All Things Considered* in February 2022 on NPR discussed third-party releases in certain high-profile bankruptcies, like *Purdue Pharma* and the *Weinstein Company*, in a heated way. *Transcript available at*: https://www.npr.org/2022/02/09/1079691038/companies-are-increasingly-using-a-legal-strategy-that-prevents-future-lawsuits
- Perhaps bolstered by the heightened public awareness and scrutiny of this issue, attention to these issues appears to be gaining momentum both in judicial forums and in Congress.

Judicial

- Judicial Developments to Watch
  - Second Circuit *Purdue* appeal (Case No. 22-110, 2d Cir.)
    - As mentioned above, the Second Circuit has taken the *Purdue* appeal under advisement after hearing oral argument on April 29, 2022, but the Second Circuit has yet to rule. The UST and certain Canadian creditors defended the District Court ruling on appeal, while creditor constituencies and the Debtors argued that the Bankruptcy Court approval of the releases was lawful and consistent with past Second Circuit precedent.

Legislative

Given the proceedings in the *Purdue* case, Representatives Carolyn B. Maloney (D-NY) and Mark DeSaulnier (D-CA) introduced the proposed Stop Shielding Assets from Corporate Known Liability by Eliminating Non-Debtor Releases Act (the "SACKLER Act") to prevent third parties from using the bankruptcy process to obtain a release from governmental claims.

- The SACKLER Act was introduced in the House on March 19, 2021 (H.R.2096) and in the Senate (by Senators Richard Blumenthal (D-CT) and Elizabeth Warren (D-MA)) on July 26, 2021 (S.2472). The Senate bill was referred to the Committee on the Judiciary on July 26, 2021. The House bill was referred to the Subcommittee on Antritrust, Commercial, and Administrative law on October 19, 2021.
- The SACKLER Act would specifically amend § 105(b) of the Bankruptcy Code to prohibit a court from enjoining or releasing a claim against a non-debtor by a State, municipality, federally recognized Tribe, or the United States (except as provided by Bankruptcy Code section 524(g)).
- However, it would also permit temporary stay, for a period not to exceed 90 days, of the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding by a State, municipality, federally recognized Tribe, or the United States against a non-debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against a non-debtor that arose before the commencement of the case under this title.

Legislative (cont'd)

Senator Elizabeth Warren (D-MA) and Rep. Jerrold Nadler (D-NY) introduced in the Senate the proposed Nondebtor Release Prohibition Act of 2021 to prevent third parties from using the bankruptcy process to obtain releases by non-debtors without their express consent.

- The Nondebtor Release Prohibition Act of 2021 was introduced on July 28, 2021 in the Senate (S.2497) and in the House by Carolyn B. Maloney (D-NY) and David N. Ciciline (D-R.I.) (H.R.4777). The House and Senate bills were referred to the Committee on the Judiciary on July 28, 2021, and on November 3, 2021, the House Committee on the Judiciary ordered the bill to be reported (amended) by the Yeas and Nays 23-17.
- The Nondebtor Release Prohibition Act of 2021 would, among other things, amend chapter 1 of title 11 by adding section 113 to provide for a prohibition (except as provided in sections 524, 1201, and 1301) of the discharge, release, termination, or modification of liability of non-debtors for claims of third-parties and of any enjoining of actions to enforce such claims or causes of action.
- However, it would permit the disposition of a non-debtor third party claim if (a) such party expressly consents in writing after clear and conspicuous notice of the proposed disposition in language appropriate for the typical holder of such a claim, (b) with such consent not to be given by (i) acceptance of a proposed plan or (ii) failing to accept or reject a proposed plan, or failing to object to a plan or any other silence or inaction, and (c) the treatment of such entity and any of their claims under a plan cannot be more or less favorable due to such consent or failure to consent.
- It would also permit temporary stay or injunction of the commencement or continuation of an action to enforce a claim or cause of action against a non-debtor or the estate against a non-debtor or property of a non-debtor, but not beyond 90 days after the date of the order for relief without the express consent of the entity whose claim or cause of action is being stayed or enjoined, with such stays subject to appellate jurisdiction under 28 U.S.C. § 158(d).

Appendix A:
Comparative Circuit-by-Circuit Case Analysis

Comparative Case Analysis by Circuit

Third-Party Releases Authorized			
Court	**Case**	**Date**	**Key Rulings**
2d Cir.	*In re Metromedia Fiber Network, Inc.*, 416 F.3d 136	July 21, 2005	• Recognized that non-debtor releases are "proper only in rare cases" because the only explicit authorization for them is in asbestos cases and section 105(a) by itself does not authorize independent relief of the releases. • Despite noting that "this is not a matter of factors and prongs," the court explained that other courts have approved non-debtor releases when: (1) the estate received a substantial consideration, (2) the claims were channeled to a settlement fund rather than extinguished, (3) the claims would indirectly impact the debtor's reorganization "by way of indemnity or contribution", (4) the plan otherwise provided for the full payment of the enjoined claims, or (5) the affected creditors consent. • Ultimately, the court noted that no case has authorized nondebtor releases absent unique circumstances and those circumstances were not present in the case. • The court rejected the third-party releases in the case but held that the appeal was equitably moot.
3d Cir.	*In re Millennium Lab Holdings II, LLC*, 945 F.3d 126	Dec. 19, 2019	• Held that the bankruptcy court had constitutional authority to confirm a plan containing third-party releases because the bankruptcy court was resolving a matter "integral to the restructuring of the debtor-creditor relationship," and found that the release provisions were "absolutely required" to effectuate the settlement at issue in the case and in turn, the restructuring was only possible because of the release provisions. • The court did not discuss the bankruptcy court's statutory authority and found the remainder of the appeal to be equitably moot.
4th Cir.	*Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704	Dec. 9, 2011	• Held that the seven factors from the Sixth Circuit's *Dow Corning* apply when determining whether a bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor. • Determined that approval of third-party releases as part of the chapter 11 plan was unwarranted without specific findings explaining that release provisions (1) were essential for reorganization; (2) were appropriate in light of the unique circumstances of the case; (3) were essential means of implementing the confirmed plan; (4) conferred some material benefit on the debtor, the estate, or its creditors; (5) were important to the plan's overall objectives; and (6) were consistent with the applicable provisions of the Bankruptcy Code. • Remanded for specific factual findings supporting its conclusions that third-party releases were warranted. (On remand, a different judge found the third-party releases unenforceable, and the district court affirmed. *See Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344 (4th Cir. 2014)).

Comparative Case Analysis by Circuit (cont'd)

Third-Party Releases Authorized			
Court	**Case**	**Date**	**Key Rulings**
6th Cir.	*In re Dow Corning Corp.*, 280 F.3d 648	Jan. 29, 2002	• Identified seven factors that when present, may authorize non-consensual third-party releases: 1) There is an identity of interests between the F.D.A. 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(es) 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.
7th Cir.	*In re Airadigm Communs., Inc.*, 519 F.3d 640	Mar. 12, 2008	• Section 524(e) does not bar a bankruptcy court from releasing non-debtors from liability to a creditor without the creditor's consent. • The "residual authority" provided by sections 105 and 1123 permit the bankruptcy court to release third parties from liability to participating creditors if the release is appropriate and not inconsistent with any provision of the Code. • The court also found it important that the release was narrow and did not include willful misconduct.
7th Cir.	*In re Ingersoll, Inc.*, 562 F.3d 856	April 15, 2009	• Citing *Airadigm* and finding residual authority under 105 and 1123 under the "unique circumstances" of the case to approve release of a non-debtor from the claims of a creditor over the creditor's objection where the release was narrow (as opposed to blanket immunity) and where the third-party would not have participated without the release, and its participation was "essential" to the reorganization.

Comparative Case Analysis by Circuit (cont'd)

Third-Party Releases Authorized			
Court	**Case**	**Date**	**Key Rulings**
S.D. Ind. (7th Cir.)	*In re USA Gymnastics*	Dec. 16, 2021	• Confirming plan, where all 476 abuse survivors who voted supported the plan, including non-debtor third-party releases (for settling insurers, the USOPC, and third-parties with rights under the insurance policies) without which the resolution of the chapter 11 case would not have been possible (including channeling injunction for sexual abuse claims) where the releases were narrowly tailored to the facts and circumstances of the case and did not offer any protection to Excluded Parties who personally committed acts of sexual abuse that could result in a claim against the Debtor or a participating party.
11th Cir.	*In re Seaside Engineering & Surveying*, 780 F.3d 1070	Mar. 12, 2015	• Agreed with *Airadigm* that section 524(e) does not foreclose a third-party release and followed *Behrmann* in commending the *Dow Corning* factors for consideration of the bankruptcy courts. • Also discussed that bankruptcy courts should have the discretion to determine which of the factors are relevant and that the factors should be considered non-exclusive. • The court affirmed the Bankruptcy Court's approval of the non-debtor releases as fair and equitable after analyzing the *Dow Corning* factors.
11th Cir.	*In re Le Ctr. on Fourth, LLC*, 17 F.4th 1326	Nov. 15, 2021	• Held that receipt of disclosure statement and plan provided creditors with actual notice of third-party releases in bankruptcy plan, thereby satisfying due process and that creditors were not entitled to modify confirmation order to proceed nominally in state court against released non-debtor third party.

Comparative Case Analysis by Circuit (cont'd)

Third-Party Releases Authorized			
Court*	**Case**	**Date**	**Key Rulings**

Bankr. D. Mass. (1st Cir.)	*In re Chi. Invs., LLC*, 470 B.R. 32	Apr. 24, 2012	• After reiterating that, as previously held, section 524(e) does not prevent third-party releases and they are authorized when appropriate and necessary under section 105(a), the court approved the disputed releases.
			• Further reiterated the multi-factor test in *Master Mortgage*, and applying those factors found that the releases "fall well within what has been approved in this district."
			  ◦ The non-debtor parties had supplied substantial consideration in the debtors' transfer of equity ownership to them as well as the assumption of certain obligations of the debtors, and the releases were essential to the reorganization because the non-debtors would not have gone forward without them.
			  ◦ Creditors were also paid in full, and the UST did not object to the releases.

Bankr. D. Mo. (8th Cir.)	*In re U.S. Fidelis, Inc.*, 481 B.R. 503	Aug. 28, 2012	• Held that the court had jurisdiction to adjudicate the third-party claims pursuant to "related to" jurisdiction. Here, the third-party claims against the non-debtor parties had a "conceivable effect" on the debtors' estate due to the intertwined relationship between the debtors and the third-parties. • Further, the court had jurisdiction to enter a final order on the third-party claims because the parties consented. Specifically, the court held that such jurisdiction may be "established by implied consent where no objection to jurisdiction is raised" and as such, the third-parties consented to the bankruptcy court's jurisdiction when they did not object. • Despite holding that certain objectors lacked standing, the court also discussed that even if they did have standing, the releases do not violate section 524(e). Further, the releases were consensual. In finding consent, the court held that voting to accept the plan is not required to establish consent. Instead, the court found consent where only three consumer creditors (the releasing parties) rejected the plan but did not object to confirmation. Further, the Attorneys General participated on behalf of the consumer creditors and supported confirmation. ◦ Finally, the court discussed that even if the releases were nonconsensual, they were authorized under the *Master Mortgage* test as "exceptional circumstances" existed.

*The 1st, 8th, and D.C. Circuits have not directly addressed the issue.

Comparative Case Analysis by Circuit (cont'd)

Third-Party Releases Authorized			
Court*	**Case**	**Date**	**Key Rulings**
Bankr. D. Mo. (8th Cir.)	*In re Master Mortgage Inv. Fund*, 168 B.R. 930	Feb. 28, 1994	• Held that under "appropriate" and "limited" circumstances, a bankruptcy court has the power to issue a third-party release and section 524(e) does not explicitly prohibit it. • Adopted a five-factor test to determine whether non-consensual third-party releases are appropriate: 1) There is an identity of interest 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 assets of the estate. 2) The non-debtor has contributed substantial assets to the reorganization. 3) The injunction is essential to reorganization. Without the it, there is little likelihood of success. 4) A substantial majority of the creditors agree to such injunction, specifically, the impacted class, or classes, has "overwhelmingly" voted to accept the proposed plan treatment. 5) The plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction. • The court noted that these are the factors most often considered but that this is not "an exclusive list of considerations."
D.C. Cir.	*In re AOV Indus.*, 792 F.2d 1140	Mar. 8, 1985	• Held that the bankruptcy court was not constitutionally prohibited from approving a plan that contained third-party releases. Otherwise, dismissed the appeal as moot.

*The 1st, 8th, and D.C. Circuits have not directly addressed the issue.

Comparative Case Analysis by Circuit (cont'd)

Third-Party Releases Not Authorized			
Court	**Case**	**Date**	**Key Rulings**
5th Cir.	*In re Zale Corp.*, 62 F.3d 746	Sept. 7, 1995	• Held that the bankruptcy court did not have jurisdiction over nondebtor releases of third-party tort claims. • Although the court found that the bankruptcy court did have jurisdiction over nondebtor releases of third-party contract claims, held that the third-party release at issue could not be authorized under section 105 of the Bankruptcy Code because it improperly discharged a potential debt of a nondebtor, thus violating section 524(e). • The court distinguished cases where courts have upheld third-party releases as those channeled claims to allow recovery from separate assets – avoiding a discharge of the nondebtor. The release at issue did not provide any alternative means for recovery and thus improperly discharged a non-debtor's debt.
5th Cir.	*In re Pac. Lumber Co.*, 584 F.3d 229	Sept. 29, 2009	• Citing *Zale* and other Fifth Circuit cases, the court stated that "in a variety of contexts, this court has held that section 524(e) only releases the debtor, not co-liable parties . . . . These cases seem broadly to foreclose non-consensual non-debtor releases and permanent injunctions." • The fact that section 524(g) was enacted to enjoin third-party asbestos claims suggests "non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets" (not present in this case). • Ultimately struck the non-debtor releases except with respect to the Creditors Committee.
5th Cir.	*In re Highland Cap. Mgmt., L.P.*, 2022 WL 3571094	Aug. 19, 2022	• Holding that provision exculpating certain non-debtor third parties, with respect to claims arising on or after the petition date and relating to the chapter 11 case, could only include the debtor, the committee, committee members, and independent directors as "Protected Parties" in light of § 524(e)'s "statutory bar on nondebtor discharge," and expressly *striking* exculpation for various other parties involved in the case including estate and committee professionals. • Finding injunction and gatekeeping provision to be lawful where it required any enjoined party seeking to bring certain claims arising from or related to the chapter 11 case and plan administration against a protected party to first seek the bankruptcy court's approval of the claim as "colorable."

Comparative Case Analysis by Circuit (cont'd)

Third-Party Releases Not Authorized			
Court	**Case**	**Date**	**Key Rulings**
9th Cir.	*Blixseth v. Credit Suisse*, 961 F.3d 1074	June 11, 2020	• Approved an exculpation clause despite previous caselaw that held section 524(e) precludes bankruptcy courts from authorizing third-party releases. The Ninth Circuit previously interpreted the section generally to prohibit a bankruptcy court from discharging the debt of a non-debtor. *See In re Lowenschuss*, 67 F.3d 1394, 1402 (9th Cir. 1995) ("this court has repeatedly held, without exception, that section 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors."). • Drew a distinction between the "release" in the exculpation clause at issue as it was not a release from creditors' claims on the debts discharged in bankruptcy but instead a narrow release of participants in the plan approval process for their actions taken during that process. • Further, the exculpation clause at issue dealt only with the "highly litigious" nature of the chapter 11 proceedings and only applied to negligence claims and was thus "narrow in both scope and time."
9th Cir. BAP	*In re CPESAZ Liquidating, Inc.*, 2022 WL 2719642	July 12, 2022	• Determined that bankruptcy court did not err in approving exculpation provisions in the plan that "extend only to the estate's professionals who worked to assist the Debtors in effectuating a plan" (excluding "willful misconduct and gross negligence") because the provisions "fell into the category of tailored, limited exculpation clauses that are not prohibited under the Code or Ninth Circuit case law."
10th Cir.	*In re W. Real Estate Fund*, 922 F.2d 592	Dec. 28, 1990	• Held that section 105(a) does not permit the grant of third-party releases because such a permanent injunction "improperly insulate[s] non-debtors in violation of section 524(e)."