

# THIRD-PARTY RELEASES

## uncontroversial releases and implementing injunctions:

- release of claims belonging to the estate
  - including claims that individual creditors or shareholders can assert outside bankruptcy
    - e.g., fraudulent transfer claims
    - corporate derivative suits
  - See, e.g., Protective Comm. v. Anderson*, 390 U.S. 414 (1968); Code § 1123(b)(3)(A)
- other *in rem* releases and injunctions
  - insurance injunctions
    - See, e.g., In re Johns-Manville Corp.*, 843 F.2d 636 (2d Cir. 1988)
  - successor liability injunctions
  - partnership debtor releases/injunctions for individual partners

uncontroversial releases and implementing injunctions:

- indemnification/contribution bar order for settling defendant

*See, e.g., In re Munford, Inc.*, 97 F.3d 449 (11th Cir. 1996)

direct claims by creditors or shareholders against non-debtor third party

- e.g., officers, directors, or other principals
- affiliates, insurers, other creditors
- guarantors
- for direct personal liability
  - e.g., fraud, conspiracy, aiding & abetting, joint tortfeasor
- cause of action does not belong to estate
  - so estate rep/s have no standing/authority to prosecute such third-party claims

*See Caplin v. Marine Midland Grace Tr. Co.*, 406 U.S. 416 (1972)

direct claims by creditors or shareholders against non-debtor third party

- (relatively) uncontroversial releases and injunctions:
  - temporary stay
    - See, e.g., Celotex Corp. v. Edwards*, 514 U.S. 300 (1995);  
*Continental Ill. Nat'l Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648 (1935)
  - consensual release
    - See, e.g., In re Specialty Equip. Cos.*, 3 F.3d 1043 (7th Cir. 1993)

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
  - and permanent “channeling” injunction
- expressly permitted for certain third-party claims in asbestos bankruptcies in 1994 *Manville* legislation
  - See Code § 524(g)(4)(A)(ii)-(iii)
  - creates no inferences of permissibility/not in other cases under (uncodified) statutory rule of construction

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - prohibited by Code § 524(e):
    - Fifth Circuit  
*See In re Zale Corp.*, 62 F.2d 746 (5th Cir. 1995)
    - Ninth Circuit  
*See In re Lowenschuss*, 67 F.2d 1394 (9th Cir. 1995)
    - Tenth Circuit  
*See In re W. Real Estate Fund*, 922 F.2d 592 (10th Cir. 1990)

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - prohibited by Code § 524(e):

“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”



direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - prohibited by Code § 524(e)
  - exculpation provisions may be treated differently
    - See, e.g., Blixseth v. Credit Suisse*, 961 F.3d 1074 (9th Cir. 2020); *In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009); *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000)

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release Circuit split
- nonconsensual releases are permissible
  - Fourth Circuit

*See In re A.H. Robins Co.*, 880 F.2d 694 (4th Cir. 1989)
  - Sixth Circuit

*See In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002)
  - Seventh Circuit

*See In re Ingersoll, Inc.*, 562 F.3d 856 (7th Cir. 2008)
  - Eleventh Circuit

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

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - not prohibited by Code § 524(e)
  - permitted by Code § 105(a):

“The court may issue any order, process, or judgment that is necessary or appropriate to carry out provisions of this title.”

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - not prohibited by Code § 524(e)
  - permitted by Code § 1123(a)(5):

“a plan shall . . . provide adequate means for the plan’s implementation”

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - not prohibited by Code § 524(e)
  - permitted by Code § 1123(b)(6):

“a plan may . . . include any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]”

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- Circuit split
  - Second and Third Circuits have equivocated
    - See In re Continental Airlines, Inc.*, 203 F.3d 203 (3d Cir. 2000);
    - In re Metromedia Fiber Network, Inc.*, 960 F.3d 136 (2d Cir. 2005)

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- recent legislation introduced to prohibit
  - Nondebtor Release Prohibition Act of 2021  
S. 2497, 117th Cong. (2021); H.R. 4777, 117th Cong. (2021)

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases are permissible

- *Master Mortgage/Dow Corning* factors:

*See In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 934-35 (Bankr. W.D. Mo. 1994); *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002)



direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases are permissible
- *Master Mortgage/Dow Corning* factors:

(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.

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases are permissible
- *Master Mortgage/Dow Corning* factors:

(2) The non-debtor has contributed substantial assets to the reorganization.

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases are permissible
- *Master Mortgage/Dow Corning* factors:

(3) The injunction is essential to reorganization. Without it, there is little likelihood of success.

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases are permissible
- *Master Mortgage/Dow Corning* factors:

(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.

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases are permissible
- *Master Mortgage/Dow Corning* factors:

(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.

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual releases
- prominent feature of several recent high-profile cases:
  - *USA Gymnastics*
  - *Boy Scouts*
  - *Purdue Pharma*

*See In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y.), vacated, 635 B.R. 26 (S.D.N.Y. 2021)

direct claims by creditors or shareholders against non-debtor third party

- nonconsensual release
- must be “related to” bankruptcy jurisdiction over released/enjoined claims
- Does a non-Article III bankruptcy judge have “core” jurisdiction to enter a final order approving a nonconsensual release?
  - YES: *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019)
  - NO: *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021); *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 2022 WL 135398 (E.D. Va. Jan. 13, 2022)

direct claims by creditors or shareholders against non-debtor third party

- consensual release
- What constitutes sufficient consent?

- vote in favor of plan?

*Compare, e.g., In re Coram Healthcare Corp.*, 315 B.R. 321 (Bankr. D. Del. 2004) (yes), with *In re Arrowmill Dev. Corp.*, 211 B.R. 497 (Bankr. D.N.J. 1997) (no)

- use of “death trap” to induce “consent” to release by vote in favor of plan

*See In re Weinstein Co. Holdings LLC*, No. 1:18-bk-10601 (D.Del.)



direct claims by creditors or shareholders against non-debtor third party

- consensual release

- What constitutes sufficient consent?

- failure to opt out of release?

- Compare, e.g., In re Indianapolis Downs, LLC*, 486 B.R. 286 (Bankr. D. Del. 2013) (yes), *with Patterson v. Mahwah Bergen Retail Gp, Inc.*, 2022 WL 135398 (E.D. Va. Jan. 13, 2022) (no)

- What constitutes failure to opt out of release?

- not signing/checking separate opt-out election

- See, e.g., In re Washington Mutual, Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011); *In re DBSD N. Am., Inc.*, 419 B.R. 179 (Bankr. S.D.N.Y. 2009); *In re Conseco, Inc.*, 301 B.R. 525 (Bankr. N.D. Ill. 2003)

- not voting on plan

- See, e.g., In re Emerald Oil, Inc.*, No. 16-10704 (Bankr. D. Del.)

- not objecting to plan

- See, e.g., In re Hertz Corp.*, No. 20-11218 (Bankr. D. Del.)