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Third-Party Releases in Chapter 11 Bankruptcy

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I. Introduction

Non-consensual third-party releases have long been controversial in chapter 11 cases.[1] But the practice of providing such releases in chapter 11 plans has come under increased scrutiny in recent years due to efforts to utilize them in mass tort chapter 11 cases such as Purdue Pharmaceutical, USA Gymnastics and Boy Scouts of America. Critics argue that such releases have increasingly been used by bad actors who have not subjected themselves to the bankruptcy process or the requirements of the Bankruptcy Code.[2]

Nevertheless, courts have frequently confirmed chapter 11 plans containing non-consensual third-party releases as long as the debtor satisfied certain criteria, such as the non-debtor's contribution of "substantial assets" or where such releases are essential to the reorganization. Currently, there is a circuit split among the courts that have ruled on the permissibility of non-consensual third-party releases in connection with a chapter 11 plan.

[1] It is important to distinguish non-consensual third-party releases from somewhat less controversial releases frequently contained in chapter 11 plans, such as exculpation provisions for estate fiduciaries and professionals, releases by a debtor, and consensual third-party releases.
[2] The Bankruptcy Code is set forth in 11 U.S.C. §§ 101 *et seq*. Specific chapters of the Bankruptcy Code are identified herein as "chapter __" and specific sections are identified herein as "section __."

Notably, the Fifth, Ninth and Tenth Circuits largely prohibit such releases,[3] whereas the Third, Fourth, Sixth, Seventh and Eleventh Circuits permit such releases in limited circumstances.[4]

In the Sixth Circuit, a debtor must clear a high evidentiary bar to obtain approval of non-consensual third-party releases. The factors a bankruptcy court must consider include:

(i) the identity of interests between the debtor and the third party, such that a suit against the non-debtor is akin to a suit against the debtor due to, for example, an indemnity obligation that may deplete the debtor's assets;
(ii) whether the non-debtor has contributed substantial assets to the reorganization;
(iii) whether the release is essential to reorganization;
(iv) whether the impacted classes of claims have overwhelmingly accepted the plan in question;
(v) the plan pays all or substantially all or a substantial portion of the claims in the classes impacted by the release,
(vi) the plan provides an opportunity for those claimants who choose not to settle to recover in full, and
(vii) whether the bankruptcy court has made a record of specific factual findings to support such releases.[5]

Over the past twenty years, the *Dow Corning* test has been adopted by bankruptcy and appellate courts all over the country.

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[3] *See, e.g., Feld v. Zale Corp (In re Zale Corp.)*, 62 F.3d 746, 760-61 (5th Cir. 1995); *Resorts Intl., Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1402 (9th Cir. 1995); *Landsing Diversified Props. v. Abel (In re Western Real Estate Fund Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990).

[4] *See, e.g., In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019); *Mabey v. Official Committee of Equity Security Holders (In re A.H. Robins Co. Inc.)*, 880 F.2d 694, 701 (4th Cir. 1989); *Matter of Specialty Equip. Cos. Inc.,* 3 F.3d 1043, 1047 (7th Cir. 1993); *SE Property Holdings, LLC v. Seaside Eng. & Surv., Inc. (In re Seaside Eng. & Surv., Inc.)*, 780 F.3d 1070 (11th Cir. 2015).

[5] *See Class Five Nevada Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002); *see also In re Master Mortg. Inv. Fund Inc.,* 168 B.R. 930 (Bankr. W.D. Mo. 1994), wherein the court articulated a similar although slightly less restrictive five-factor test that considers:

(i) the identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete assets of the estate;
(ii) whether the nondebtor has contributed substantial assets to the reorganization;
(iii) whether the injunction is essential to reorganization;
(iv) whether a substantial majority of the creditors agree to such injunction — specifically, whether the impacted class or classes have "overwhelmingly" voted to accept the proposed plan treatment; and
(v) whether 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.

II. The Argument Against Non-Consensual Third-Party Releases

The argument against non-consensual third-party releases in bankruptcy plans generally starts with section 524(e), which provides:

> Except as provided in subsection (a)(3) of this section, 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.[6]

Critics of non-consensual third-party releases argue that section 524(e) constitutes a direct prohibition against the release of any person or entity by the bankruptcy court where that person or entity is not itself the subject of a bankruptcy discharge.[7]

There is, of course, a statutory exception to section 524(e) in section 524(g). But that exception only applies in asbestos cases.[8] In such cases, section 524(g) permits releases and channeling injunctions protecting non-debtors (usually, but not exclusively, insurance companies) where the legal requirements of section 524(g)(2)(B) are met. Section 524(g) was enacted in the wake of the *Johns-Manville* bankruptcy cases, where releases were approved by the Second Circuit Court of Appeals in favor of insurers who collectively funded an $850 million trust to pay current and future tort claimants.[9] The stated rationale for the statutory provision is that, absent such relief, "companies would be forced into liquidation and lose their ability to generate stock value and profits that can be used to satisfy claims."[10]

Based on section 524(g), some may infer that Congress only intended that bankruptcy courts have this authority in the asbestos area. However, that position is belied by statements in the House Report that Congress was expressing no opinion on the authority of a bankruptcy court

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[6] 11 U.S.C. § 524(e).
[7] *See, e.g., In re Lowenschuss*, 67 F.3d at 1401-2 (holding that section 524(e) acts as an affirmative bar to non-consensual third-party releases).
[8] 11 U.S.C. § 524(g)(1)(B)(i)(I).
[9] *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89 (2d Cir. 1988).
[10] H.R. Rep. 103-834, 103rd Cong., 2nd. Sess. 8-12 (Oct. 4, 1994); 140 Cong. Rec. H10765 (Oct. 4, 1994).

to issue an enforceable injunction of this kind in other types of cases using their general equitable powers.[11] Congress resolved to revisit non-consensual third-party releases in non-asbestos contexts in future years but, unfortunately, it never did.

Additionally, there are significant due process and jurisdictional concerns associated with non-consensual third-party releases. When a court directs that a third party's claim against a non-debtor be released, it takes away a property interest that belongs to that third party. This practice is contrary to the generally understood limitations on judicial power. A court generally may not force parties to forego claims and may not dictate settlement terms.[12] Rather, the judicial power is limited to adjudicating claims brought before a court on the merits. This is true, it is argued, even though the release of the third-party claim might help achieve an important bankruptcy objective, such as allowing a debtor to reorganize or paying creditors.

Non-consensual third-party releases raise jurisdictional concerns as well. Bankruptcy courts have *in rem* jurisdiction over a debtor's property. They also have jurisdiction over "cases and proceedings" that "arise under" the Bankruptcy Code, or that "arise in" or are "related to" bankruptcy cases.[13] In recent years the Supreme Court has taught us that, in the absence of consent, a bankruptcy court does not have constitutional authority to render a final decision in a case where it only has "related to" jurisdiction.[14] Non-consensual third-party release provisions contained in chapter 11 plans usually apply broadly to claims where the court does not have any arguable jurisdiction, much less constitutional authority, in that they involve claims between a creditor and

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[11] *Id.*
[12] *See United States v. Ward Baking Co.*, 376 U.S. 327, 334 (1964).
[13] 11 U.S.C. § 1334.
[14] *See, e.g., Wellness Int'l Network v. Sharif*, 135 S. Ct. 1932, 1939 (2015); *Stern v. Marshall*, 564 U.S. 462, 471-72 (2011).

a non-debtor. It is difficult to argue that a court can provide a non-consensual release with respect to a claim when the court could not even have rendered a final decision on such claim.

Finally, it can be argued that non-consensual third-party releases are inappropriate from a policy perspective. The argument is that bankruptcy, and the discharge provided therein, exists to help troubled debtors. In exchange for such relief, debtors are required to disclose their assets and subject themselves to a rigorous and transparent process dictated by the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. Non-debtors who obtain third-party releases, it is argued, are improperly enjoying the benefits of bankruptcy without bearing its corresponding responsibilities and burdens.

III. The Argument In Favor of Permitting Non-Consensual Third-Party Releases

There are both statutory and policy arguments in favor of non-consensual third-party releases as well. First, proponents argue, such releases are not prohibited by any Bankruptcy Code section. Section 524(e), for example, does not affirmatively prohibit all third-party releases. Rather, it is a savings clause that clarifies that the discharge of claims against a debtor does not by itself discharge claims against others.[15] As the Eleventh Circuit Court of Appeals stated in *In re Seaside Engineering & Surveying*: "524(e) says nothing about the authority of the bankruptcy court to release a nondebtor from a creditor's claims."[16] That court went on to say that if Congress meant to prohibit such releases it could have said so expressly or it could have created it as a requirement for plan confirmation under section 1129(a).

Second, it is frequently argued that section 105(a) supports the argument that non-consensual third-party releases are permissible. Section 105 is called "Power of the Court," and subsection (a) states that: "the court may issue any order, process, or judgment that is necessary or

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[15] *Airadign Comm., Inc. v. FCC (In re Airadigm Comm., Inc.)*, 519 F.3d 640 (7th Cir. 2008).
[16] *In re Seaside Engineering & Surveying, Inc.*, 780 F. 3d 1070 (11th Cir. 2015).

appropriate to carry out the provisions of this title."[17] Unquestionably, the primary goals in a chapter 11 case include funding creditor recoveries and allowing a debtor to obtain a fresh start. In the real-world, particularly in mass tort cases, third-party releases are often necessary to achieve such goals.

Third, it has been argued that section 1123(b)(6) provides support for non-consensual third-party releases.[18] Section 1123(b) consists of a list of optional chapter 11 plan provisions. Subsection (6) provides that a chapter 11 plan may contain: "any other appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code.[19] Since, proponents argue, section 524(e) does not expressly prohibit non-consensual third-party releases, section 1123(b)(6) contemplates that they are permissible.

Finally, from a purely policy perspective, it has been argued that the ability of bankruptcy courts to grant non-consensual releases in limited circumstances allows for parties and their professionals to craft creative settlements in unique, complex cases, such as the mass tort cases. Such settlements can have the effect of avoiding expensive, multi-party, value-destructive litigation. They frequently are the best way of addressing a horrible situation. Supporters of allowing judicial discretion to approve non-consensual third-party releases argue that the inability to provide such releases may hinder a business' ability to reorganize and may make it harder to put money in the pockets of victims. For example, a debtor may need the assistance of non-debtor parties (such as insiders, affiliates, lenders or insurers) to effectuate its reorganization plan. This assistance may be in the form of service, collaboration, funding, business commitments, or other means that allow the debtor to achieve its objectives in the chapter 11 case or in its post-

[17] 11 U.S.C. § 105(a).
[18] *In re Hercules Offshore, Inc.*, 565 B.R. 732 (Bankr. D. De. 2016); *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002).
[19] 11 U.S.C. § 1124(b)(6).

confirmation operations. Non-debtor parties may be reluctant to contribute to the plan or the debtor's reorganization efforts if they have ongoing liability.

Notably, the American Bankruptcy Institute's exhaustive 2014 report and recommendations on bankruptcy reform considered the propriety of non-consensual third-party releases in chapter 11 plans. The ABI Commission stated as follows:

> The Commission considered this basic question: Should the Bankruptcy Code prohibit third-party releases in chapter 11 plans? The Commission agreed that a blanket prohibition on third-party releases was inadvisable. The Commissioners discussed case examples and particular fact patterns in which third-party releases facilitated a confirmable plan and ultimately benefited all stakeholders. They recognized, however, that third-party releases might not be appropriate in every chapter 11 case. For example, a release provision could be overly broad or not really necessary, particularly in cases where the benefits of the release to the estate are nominal, but the harm to creditors is significant. Accordingly, the Commission rejected carte blanche approval of third-party releases, as well as a presumption in favor of such releases.[20]

Ultimately, the ABI Commission recommended the allowance of non-consensual third-party releases based on a consideration of the fact-intensive standard set forth in *In re Master Mortgage Investment Fund* and discouraged the imposition of a blanket prohibition against such releases.

IV. The Recent Case Law

Recent high-profile opinions from district courts in the Southern District of New York and the Eastern District of Virginia, two of the busiest bankruptcy jurisdictions in the country, have brought this issue to the forefront and raised increased doubts about whether bankruptcy courts can ever approve non-consensual third-party releases.

a. Purdue Pharmaceutical

[20] *See* AMERICAN BANKRUPTCY INSTITUTE COMMISSION TO STUDY THE REFORM OF CHAPTER 11, 2012-2014 Final Report and Recommendations 255-56 (2014).

In a 142-page opinion issued on December 16, 2021, Judge Colleen McMahon of the United States District Court for the Southern District of New York ruled that non-consensual releases of creditors' direct claims against non-debtor entities are not permitted under the Bankruptcy Code in *In re Purdue Pharma, L.P.*[21] As a result of the ruling, the order confirming the plan of reorganization in the bankruptcy cases of Purdue Pharmaceutical and its affiliated entities (collectively, "Purdue") was vacated. Days after the issuance of the opinion, Purdue asked the bankruptcy court to maintain a two-year freeze on more than 2,600 opioid-related lawsuits against non-debtors while it appeals the decision to the Second Circuit Court of Appeals. That stay remains in place as of this writing.

Purdue's bankruptcy was occasioned by the opioid health crisis that has plagued the country for over two decades. This health crisis can largely be traced to over-prescription of highly addictive pain relief medications including, specifically and principally, Purdue's proprietary, OxyContin. Between 1996 and 2019, Purdue had revenues of $34 billion, with 91% emanating from OxyContin. By 2001, OxyContin was "the most prescribed brand-name narcotic mediation" in the United States, and rates of opioid addition were skyrocketing through the country.[22] According to the Centers for Disease Control and Prevention, from 1999 to 2019, "nearly 247,000 people died in the United States from overdoses involving prescription opioids."[23]

Despite a 2007 plea agreement with the federal government, in which Purdue admitted that it had, among other misdeeds, falsely marketed OxyContin as non-addictive, Purdue's profits after 2007 were driven almost exclusively by its aggressive marketing of OxyContin. As a result, by 2019, Purdue and its insiders were facing thousands of lawsuits brought by government entities

[21] *In re Purdue Pharma, L.P.*, 2021 WL 5979108 (S.D.N.Y. Dec. 16, 2021).
[22] *Id.* at *16-17.
[23] *Id.* at *18.

and individuals who had become addicted to OxyContin, and by the estates of individuals who had overdosed – either on OxyContin itself or on the street drugs such as heroin and fentanyl for which OxyContin served as a feeder.

Engulfed in what Judge McMahon described as "a veritable tsunami of litigation,"[24] Purdue filed for relief under chapter 11 in September 2019. The intent of the bankruptcy filing was for a "*Manville*-style" bankruptcy that would resolve both existing and future claims against: (i) Purdue, and (ii) certain non-debtor affiliates of the company – principally members of the Sackler family that had founded and managed Purdue throughout its history.[25]

Over 614,000 creditors filed claims in Purdue's bankruptcy case. The damages asserted in such claims exceeded $2 trillion.[26] For two years, the key stakeholders in the case negotiated with Purdue and the Sackler family through mediation and otherwise. Those negotiations ultimately resulted in a proposed plan of reorganization that would, if implemented, afford billions of dollars for the resolution of claims, while funding opioid relief and education programs. Although the plan contained several beneficial features (including a gradual dissolution of Purdue, a document repository where Purdue materials would be made available for public review, and support for various opioid overdose reversal and addiction treatment medications), the most salient feature of the plan was a $4.325 billion contribution by the Sackler family.

The plan was approved by over 95% of the 120,000 creditors who voted.[27] It was confirmed "with obvious reluctance" by a highly respected bankruptcy judge in September 2021

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[24] *Id.* at *1.
[25] Judge McMahon notes that, "In large part due to the success of their pharmaceutical business, the Sackler family have long been ranked on Forbes' list of America's Richest Families, becoming one of the top twenty wealthiest families in America in 2015, with a reported net worth of $14 billion dollars." *In re Purdue Pharma, L.P.*, 2021 WL 5979108 at *5 (S.D.N.Y. Dec. 16, 2021).
[26] *Id.* at *47.
[27] It is noteworthy that while 614,000 creditors filed claims, only 124,000 voted on the plan.

who, after applying the traditional standard for approving settlements in bankruptcy, concluded that there existed no other reasonably conceivable means to achieve the result that would be accomplished by the plan.[28]

Eight states, the District of Columbia, the United States Trustee, the U.S. Attorney's Office and several individual personal injury claimants, among others, appealed confirmation of the plan.[29] The appellants asserted that the plan impermissibly provided for broad, non-consensual third-party releases of claims against members of the Sackler family and their affiliates, none of whom had subjected themselves to the bankruptcy process. Such claims included direct claims predicated on fraud (which claims could not be discharged pursuant to section 523(a) if the Sacklers themselves had sought bankruptcy relief), misrepresentation, and willful misconduct under various state consumer protection statutes.

In the face of such claims, the Sacklers allegedly had engaged in an aggressive scheme to fraudulently transfer their assets:

> As the opioid crisis continued and worsened in the wake of Purdue's 2007 Plea Agreement, the Sacklers … were well aware that they were exposed to personal liability over OxyContin. Concerned about how their personal financial situation might be affected, the family began what one member described as an "aggressive" program of withdrawing money from Purdue almost as soon as the ink was dry on the 2007 papers. The Sacklers upstream[ed] some $10.4 billion out of the company between 2008 and 2017, which, according to their own expert, substantially reduced Purdue's "solvency cushion." Over half of that money was either invested in offshore companies owned by the Sacklers or deposited into spendthrift trusts that could not be reached in bankruptcy and off-shore entities located in places like the Bailiwick of Jersey.
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> When the family fortune was secure, the Sackler family members withdrew from Purdue's Board and management. Bankruptcy discussions commenced the following year. As part of those pre-filing discussions, the Sacklers offered to contribute toward a settlement, but if – and only if – every member of the family

[28] *Id.* at *34, 62. The bankruptcy court opinion confirming the plan can be found at *In re Purdue Pharma, L.P.*, 2021 WL 4240974 (Bankr. S.D.N.Y. Sept. 17, 2021).
[29] Importantly, the parties agreed to stay implementation of the plan thereby avoiding equitable mootness issues.

could "achieve global peace" from all civil (not criminal) litigation, including litigation by Purdue to claw back the money that had been taken out of the corporation.[30]

The appellants attacked the legality of the plan's non-consensual release of third-party direct claims against non-debtors and asserted that the plan constituted an abuse of the bankruptcy process. Conversely, Purdue and those who supported the plan argued that the settlements contemplated therein were permissible under the Bankruptcy Code and maximized the distribution to creditors given the expense, delay and risk associated with litigating claims against the Sacklers.

Recognizing the importance of the issue, Judge McMahon stated:

> The great unsettled question in this case is whether the Bankruptcy Court – or any court – is statutorily authorized to grant such releases. This issue has split the federal Circuits for decades. While the Circuits that say no are united in their reasoning, the Circuits that say yes offer various justifications for their conclusions. And – crucially for this case – although the Second Circuit identified the question as open back in 2005, it has not yet had occasion to analyze the issue. Its only guidance to the lower courts, uttered in that 2005 opinion, is this: because statutory authority is questionable and such releases can be abused, they should be granted sparingly and only in "unique" cases.
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> This will no longer do. Either statutory authority exists or it does not…. Moreover, the lower courts desperately need a clear answer. As one of my colleagues on the Bankruptcy Court recently noted, plans releasing non-debtors from third party claims are no rarity: "…*Almost every proposed Chapter 11 Plan that I receive includes proposed releases*." When every case is unique, none is unique. Given the frequency with which this issue arises, the time has come for a comprehensive analysis of whether authority for such releases can be found in the Bankruptcy Code – that "comprehensive scheme" devised by Congress for resolving debtor-creditor relations.
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> This opinion will not be the last word on the subject, nor should it be. This issue has hovered over bankruptcy law for thirty-five years – ever since Congress added §§ 524(g) and (h) to the Bankruptcy Code. It must be put to rest sometime; at least in this Circuit, it should be put to rest now.[31]

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[30] *Id.* at *4-5.

[31] *Id.* at *6-8 (citing *In re Aegean Marine Petroleum Network Inc.,* 599 B.R. 717, 726 (S.D.N.Y. 2019) (emphasis in original).

Ultimately, Judge McMahon held that the Bankruptcy Code does not authorize non-consensual third-party releases of direct claims against non-debtors: "not in its express text (which is conceded); not in its silence (which is disputed); and not in any section or sections of the Bankruptcy Code that, read singly or together, purport to confer generalized or "residual" powers on a court sitting in bankruptcy."[32] The court noted that: "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."[33]

In reaching its conclusion, the court looked to see if there was any authorization for non-consensual third-party releases in: (a) the statutory text, (b) the circuit case law, both in the Second Circuit and elsewhere, and (c) in any "residual authority" granted to bankruptcy courts. Starting with an analysis of the statutory authority, Judge McMahon noted that the bankruptcy court had concluded that it was statutorily authorized to approve the releases of direct, third-party claims against non-debtors pursuant to sections 105(a), 524(e), 1123(a)(5) and 1129(a)(1). Judge McMahon disagreed, holding that none of the aforementioned sections confer on bankruptcy courts the power to approve the release of direct third-party claims against non-debtors.

Judge McMahon found that "one and only one section of the Bankruptcy Code expressly authorizes a bankruptcy court to enjoin third party claims against non-debtors without the consent of those third parties."[34] That section, section 524(g), expressly provides for such an injunction in limited circumstances involving injuries arising from the manufacture and sale of asbestos. She

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[32] *Id.* at *7.
[33] *Id.* at *92.
[34] *Id.* at *96.

explained the origins of section 524(g).[35] Despite the Second Circuit's affirmance of the *Manville* injunction, she explained, "questions continued to be raised about its legality."[36] Congress passed section 524(g) and (h) to remove any doubt that those injunctions were authorized in the limited context of asbestos cases.

The court found that the text of section 524(g) plainly indicates that Congress believed that it was creating an exception to what would otherwise be the applicable rule of law.[37] Moreover, she found, the legislative history clarifies that the "special rule" being devised for asbestos cases was not intended to alter any authority bankruptcy courts may already have in other contexts. The court found particularly persuasive the following text from the legislative history:

> The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved. *How the new statutory mechanism works in the asbestos area may help the Committee judge whether the concept should be extended into other areas*.[38]

Based on this language, the court reasoned, Congress left to itself, not the courts, the task of determining whether to extend a rule permitting non-debtor releases to other areas. Noting that Congress "has been deafeningly silent on this subject" for over 25 years, she concluded that Congress had elected not to expand the authority granted in section 524(g) outside of the asbestos context.[39]

Judge McMahon looked at the other sections of the Bankruptcy Code that are frequently cited as providing authorization for non-consensual third-party releases – section 1123(b)(6) (providing that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]), section 1123(a)(5) (providing that a plan of

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[35] *Id.* at *97 (discussing *In re Johns-Manville Corp.*, 837 F.2d at 91).
[36] *Id.* at *98.
[37] *Id.* at *97 (discussing the text of section 524(g)).
[38] *Id.* at *100 (internal citations omitted) (emphasis added).
[39] *Id.*

reorganization must "provide adequate means for [its] implementation") and section 1129(a)(1) (providing that a bankruptcy court "shall confirm a plan only if … the plan complies with the applicable provisions of this title"). Each section, she found, like section 105(a), "confers on the Bankruptcy Court only the power to enter orders that carry out other, substantive provisions of the Bankruptcy Code."[40] None of them creates any substantive right to approve the proposed releases.

The district court then rejected the argument that bankruptcy courts must be authorized to approve such releases because no provision of the Bankruptcy Code expressly prohibits them, reasoning: "The notion that statutory authority can be inferred from Congressional silence is counterintuitive when, as with the Bankruptcy Code, Congress put together a 'comprehensive scheme' designed to target 'specific problems with specific solutions.'"[41] Granting releases to non-debtors, she stated, "is so far outside the scope of the Bankruptcy Code and the purposes of bankruptcy that the 'silence does not necessarily mean consent' principle" must be rejected.[42] In fact, she concluded, "the silence that speaks volumes is the twenty-seven years of unbroken silence that have passed since Congress said, 'We are limiting this to asbestos for now, and maybe, when we see how it works in that context, we will extend it later.'"[43]

Judge McMahon also analyzed the case law, noting that the Supreme Court has never specifically considered whether non-consensual third-party releases can be approved in bankruptcy. Despite the Supreme Court's silence, she did find guidance for her analysis in several recent opinions from the Court. For example, she noted that the Supreme Court has held that the "traditional equitable power" of a bankruptcy court "can only be exercised within the confines of

[40] *Id.* at *120.
[41] *Id.* at *127 (citing *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012)).
[42] *Id.*
[43] *Id.* at *129-130.

the Bankruptcy Code."[44] Additionally, she noted that in two recent cases, the Supreme Court has held that "a bankruptcy court lacks the power to award relief that varies or exceeds the protections contained in the Bankruptcy Code – not even in 'rare' cases, and not even when those orders would help facilitate a particular reorganization."[45]

With these holdings in mind, Judge McMahon surveyed the circuits. She concluded that "The only fair characterization of the law on the subject of statutory authority to release and enjoin the prosecution of third-party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear."[46] She characterized this as "a most unfortunate circumstance when dealing with a supposedly uniform and comprehensive nationwide scheme to adjust debtor-creditor relations."[47]

Finally, the court addressed the argument that bankruptcy courts have "residual authority" to approve non-consensual third-party releases. The bankruptcy court, she noted, had accepted the plan proponents' argument that the Supreme Court had held, in a case called *In re Energy Resources Co.*,[48] that a bankruptcy court has "residual authority" to approve reorganization plans that include "necessary and appropriate" provisions, as long as those provisions are not inconsistent with the Bankruptcy Code. Even if such power existed, she concluded, it "is of no help where, as here, it is being exercised in contravention of specific provisions of the Bankruptcy Code."[49] Stating that she was convinced that the non-consensual third-party releases contemplated

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[44] *Id.* at *101 (discussing *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)).
[45] *Id.* at *101-103 (discussing *Law v. Siegel,* 571 U.S. 415 (2014) (holding that bankruptcy courts do not have "a general, equitable power") and *Czyzewski v. Jevic Holdings Corp.,* 137 S. Ct. 973 (2017) (holding that the protections explicitly afforded by the Bankruptcy Code could not be overridden in a "rare" case, even if doing so would carry out certain bankruptcy objectives)).
[46] *In re Purdue Pharma, L.P.*, 2021 WL 5979108 at *117 (S.D.N.Y. Dec. 16, 2021).
[47] *Id.*
[48] *Id.* at *133 (discussing *In re Energy Resources Co.*, 495 U.S. 545 (1990)).
[49] *Id.* at *132.

in the plan were in fact inconsistent with sections 524(g) and (h), section 523 and section 1141(d), she held that no residual power could authorize the releases.

In conclusion, Judge McMahon held that the releases contained in the plan were impermissible due to the absence of statutory authority for such releases. Based on the foregoing, Judge McMahon vacated Purdue's confirmation order. Acknowledging the significance of her decision, Judge McMahon closed by stating:

> It is indeed unfortunate that that this decision comes very late in a process that, from its earliest days in 2019, has proceeded on the assumption that [the releases] would be authorized – this despite the language of the Bankruptcy Code and the lack of any clear ruling to that effect. I am sure that the last few years would have proceeded in a very different way if the parties had thought otherwise. But that is why the time to resolve this question for once and for all is now – for this bankruptcy, and for the sake of future bankruptcies. It should not be left to debtors and their creditors to guess whether such releases are statutorily authorized; and it most certainly should not be the case that their availability, or lack of same, should be a function of where a bankruptcy filing is made.
>
> I also acknowledge that the invalidating of these releases will almost certainly lead to the undoing of a carefully crafted plan that would bring about many wonderful things, including especially the funding of desperately needed programs to counter opioid addiction. But just as, "A court's ability to provide finality to a third-party is defined by its jurisdiction, not its good intentions," so too its power to grant relief to a non-debtor from non-derivative third party claims "can only be exercised within the confines of the Bankruptcy Code."[50]

On March 10, 2022, the bankruptcy court approved a revised, mediator-brokered, settlement with the objecting States which resulted in at least another $1 billion being contributed by the Sacklers, with the possibility of another half billion from future sales of Sackler-related assets (bringing the total to $6 billion). This modified settlement has been incorporated into the appeal of Judge McMahon's opinion, which appeal is currently pending before the Second Circuit Court of Appeals. Oral argument was held in the Second Circuit in April 2022, and a ruling is forthcoming.

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[50] *Id.* at *136-37 (internal citations omitted).

b. Ascena Retail Group

One month later, the District Court for the Eastern District of Virginia issued an opinion that is, in many ways, similar to the Purdue opinion. In *In re Ascena Retail Group*,[51] the court reversed confirmation of a plan that contained broad, non-consensual, third-party releases and exculpation provisions.

The debtors, Ascena Retail Group, were women's apparel retailers that operated nearly 3,000 stores throughout North America. Many of the brands held by the debtors are household names such as Ann Taylor, LOFT, and Lane Bryant. The debtors were forced to close stores during the COVID pandemic, eventually resulting in a bankruptcy filing. After completing a section 363 sale, the debtors liquidated their businesses through a chapter 11 plan that was confirmed by the bankruptcy court.[52]

The *Ascena* district court began its analysis by expressing a general view on third-party releases. The court noted that third-party releases inherently lend themselves to abuse and are disfavored. This is generally consistent with the Fourth Circuit's view on the issue; that court has explained that third-party releases should be granted "cautiously and infrequently."[53] The district judge complained that approval of third-party releases have become commonplace in chapter 11 cases in the district, which has in recent years become one of the busiest business bankruptcy courts in the country.

The court's two fundamental issues with the releases in *Ascena* involved the breadth of the releases, and the bankruptcy court's failure to properly determine whether the releases satisfied established tests. The plan in *Ascena* sought to release the claims of hundreds of thousands of

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[51] *Patterson v. Mahwah Bergen Retail Group, Inc. (In re Ascena Retail Group)*, 636 B.R. 641 (E.D. Va. 2022).
[52] *Id.* at 656.
[53] *Id.* at 654 (citing *Behrmann v. Nat'l. Heritage Found.*, 663 F.3d 704, 712 (4th Cir. 2011)).

potential plaintiffs not involved in the bankruptcy. The expansive nature of the releases led the district court to describe them as "shocking" and without bounds.[54]

Specifically, the court was critical of the bankruptcy court's failure to address its jurisdiction and constitutional authority with respect to such non-debtor claims.[55] Acknowledging that such a task would have been a significant undertaking given the nature of the releases under the plan, the court stated "the enormity of the task does not absolve the bankruptcy court of its responsibility to properly identify the content of the claims before it and ensure that it has jurisdiction to rule on each of them."[56] The district court conducted a cursory review of the potential claims being released and found that many of them had absolutely no bearing on the chapter 11 case or the plan, as they involved non-debtor parties. Due to the bankruptcy court's failure to review the claims, as well as the lack of relation of the claims to the plan itself, the district court ruled that the bankruptcy court had exceeded the constitutional limits of its authority by releasing, and thereby adjudicating, the claims.[57]

Because the Fourth Circuit does permit non-debtor releases, albeit "cautiously" and infrequently, the district court in *Ascena* did not take issue that non-debtor releases were included in the plan. However, the district court made it clear that the bankruptcy court did not subject the releases to the proper 7-part test adopted by the Fourth Circuit. By following this test and making specific findings of fact, a bankruptcy court can determine whether it is justified in approving the drastic and extraordinary remedy of non-debtor releases. The district court concluded that the bankruptcy court had failed to make those findings of fact as to whether each of the proposed releases were supported by unique circumstances, and merely concluded that the releases were

[54] *Id.* at 655.
[55] *Id.* at 682.
[56] *Id.* at 689.
[57] *Id.* at 670-71.

"integral" to the plan.[58] The district court conducted a high-level review of the proposed releases and applied such factors. It ultimately held that most of the releases could not satisfy the 7-factor test. Thus, the court held, the third-party releases must be voided and rendered unenforceable.[59]

V. Conclusion

Although non-consensual third-party releases continue to be permissible in the Sixth Circuit based on the court's *Dow Corning* opinion, there does appear to be a trend in the case law in favor of increased scrutiny of such releases when they are included in a chapter 11 plan. In particular, the impact of the jurisdictional and constitutional authority issues raised in the *Stern v. Marshall* line of cases cannot be understated. It is expected that the forthcoming opinion by the Second Circuit Court of Appeals in *In re Purdue Pharmaceutical* will provide additional guidance regarding the permissibility of such releases.

[58] *Id.* at 689-90.
[59] *Id.* at 690.

76TH JUDICIAL CONFERENCE OF THE SIXTH CIRCUIT
AUGUST 31-SEPTEMBER 2, 2022

PANEL SESSION, WEDNESDAY, AUGUST 31, 2022, 3:00-4:00 P.M.

THIRD-PARTY RELEASES IN CHAPTER 11 BANKRUPTCY

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These materials focus on the permissibility of including non-consensual third party releases in a chapter 11 plan of reorganization within the Sixth Circuit, and the seven-factor test for determining the presence of unusual circumstances justifying the approval of such release provisions under the standards articulated by the United States Court of Appeals for the Sixth Circuit in its landmark ruling in the case of *In re Dow Corning Corp*., 280 F.3d 648 (2002).

Introduction

The main goal of virtually every chapter 11 case is to find the best alternative for preserving and maximizing the value of the debtor's assets, and using the benefits and powers of the bankruptcy process to negotiate a plan to repay creditors and either reorganize or liquidate the business. Chapter 11 provides a centralized judicial process to facilitate those negotiations, which will most always involve heavily negotiated and hard fought compromises as the parties endeavor to resolve contentious claims and disputes along the way.

The end result is hopefully a consensual plan that meets the requirements for confirmation under section 1129(a) of the Bankruptcy Code. Sometimes, however, negotiations are only partially successful or not successful at all, and the debtor attempts to approve a plan on a cramdown basis under section 1129(b) of the Bankruptcy Code. Either way, the process has often been likened to sausage-making, and plans are often predicated on the approval of an array of negotiated agreements big and small. Sometimes those agreements include consensual or non-consensual releases in favor of third parties. Non-consensual releases have proven to be problematic in terms of a bankruptcy court's jurisdiction and authority to approve them. Indeed, there is a split among the federal judicial circuits on this issue.

While the state of the law is very much jurisdiction-specific, one thing is clear. Granting third party releases on a non-consensual basis is extraordinary relief, to be granted only in rare cases and under what the Sixth Circuit in *Dow Corning* calls "unusual circumstances." These kinds of provisions are the exception, not the rule, and need to be justified by specific factual findings that evidence the unusual circumstances necessary to approve such provisions within the Sixth Circuit.

Jurisdiction And Statutory Authority

Like all federal courts, a federal bankruptcy court has limited jurisdiction. "The subject matter jurisdiction of the bankruptcy court is limited to that which [C]ongress specifically grants." *Wasserman v. Immormino (In re Granger Garage, Inc.)*, 921 F.2d 74, 77 (6th Cir. 1990).

District courts have original and exclusive jurisdiction over all cases under title 11. 28 U.S.C. § 1334(a). District courts also have original, but not exclusive, jurisdiction over all civil proceedings arising under title 11, or arising in or related to a case under title 11. 28 U.S.C. § 1334(b). District courts may refer all such cases and civil proceedings to the bankruptcy judges for the district. 28 U.S. § 157(a).

Upon referral from the district court, bankruptcy courts have jurisdiction to hear and determine all bankruptcy cases and all "core" civil proceedings arising under title 11 or arising in a case under title 11. 28 U.S.C. § 157(b)(1). Among other things, core proceedings include the confirmation of plans. 28 U.S.C. § 157(b)(2)(L).

However, when it comes to "non-core" civil proceedings, bankruptcy courts may hear those proceedings that are related to a case under title 11, but absent the consent of all parties, the bankruptcy judge is only authorized to submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering such findings and conclusions de novo. 28 U.S.C. § 157(c).

"Put simply: If a matter is core, the statute empowers the bankruptcy judge to enter final judgment on the claim, subject to appellate review by the district court. If a matter is non-core, and the parties have not consented to final adjudication by the bankruptcy court, the bankruptcy judge must propose findings of fact and conclusions of law. Then, the district court must review the proceeding *de novo* and enter final judgment." *Exec. Bens. Ins. Agency v. Arkinson*, 573 U.S. 25, 34 (2014).

Generally speaking, a civil proceeding is related to a case under title 11 if the outcome of the proceeding could conceivably have any effect on the bankruptcy estate. *Papas v. Buchwald Capital Advisors, LLC (In re Greektown Holdings, LLC)*, 728 F.3d 567, 577 (6th Cir. 2013). "An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankruptcy estate." *Id.*, quoting *In re Dow Corning*, 86 F.3d 482, 489 (6th Cir. 1996).

Congress intended to "grant comprehensive jurisdiction to the bankruptcy courts so that they might deal efficiently and expeditiously with all matters connected with the bankruptcy estate." *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995), quoting *Pacor, Inc. v. Higgins*, 743 F.2d 984 (3rd Cir. 1984). However, "related to" jurisdiction is not limitless. *Id.*

One bankruptcy court has held that, in the Sixth Circuit, "matters concerning nonconsensual third-party releases in the context of a proposed plan of reorganization are within the bankruptcy court's

subject matter jurisdiction." *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 746 (Bankr. N.D. Ohio 2019).

As discussed below, the relevant statutory authority for approving non-consensual third party releases in the context of a plan is based on the following provisions:

Section 105(a). "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

Section 1123(b)(6). "Subject to subsection (a) of this section, a plan may … include any other appropriate provision not inconsistent with the applicable provisions of this title."

Some court have pointed to section 524(e) for authority to say that non-consensual third party releases are categorically not permitted. That section provides: "Except as provided in subsection (a)(3) of this section, 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." 11 U.S.C. § 524(e). As noted below, the Sixth Circuit has flatly rejected this argument.

The Law In The Sixth Circuit

The standards for approving a non-consensual third party release contained in a chapter 11 plan of reorganization is set forth in the Sixth Circuit's landmark ruling in the *Dow Corning* case.

A. *What Happened In Dow Corning*

Dow Corning was a mass tort personal injury bankruptcy case involving the manufacture and sale of silicone gel breast implants.

Dow had almost fifty percent of the entire silicone gel breast implant market. Certain medical studies were done in the 1980s suggesting that silicone gel may cause auto-immune tissue diseases, and in 1992, the FDA ordered that silicone gel implants be taken off the shelf. Dow stopped manufacturing and marketing its product, and tens of thousands of implant recipients sued Dow and its two shareholders, the Dow Chemical Company and Corning, Incorporated.

The litigation was consolidated into multidistrict litigation proceedings that led to a global settlement in excess of $4.2 billion. However, the settlement fund was inundated with claims filed by hundreds of thousands more women than anticipated, and the settlement ultimately collapsed. A chapter 11 bankruptcy filing followed in the Eastern District of Michigan.

It took years of extensive negotiation and mediation to cobble together a proposed plan of reorganization. The plan provided for a $2.35 billion settlement fund using funds contributed by Dow's products liability insurers and shareholders, and Dow's own operating cash reserves. The plan gave claimants the option to either settle their litigation claims under certain terms or proceed with litigation. In exchange for the financial contributions, the plan provided a release to Dow's insurers and shareholders from all further liability for any personal injury claim settled per the plan, and permanently enjoined anyone with a claim that was released against Dow from suing the insurers or shareholders for that claim.

The plan had thirty-three classes and subclasses of claims. Class 15 was composed of government payer claims held by the U.S. and the governments of various Canadian provinces. The U.S. had the right to recover certain claims from insurers and other third parties, and those rights were not adequately protected under the plan and were effectively cut off in certain situations. The class voted against the plan.

The bankruptcy court confirmed the plan, but limited the release provisions only to consenting creditors. The district court affirmed the confirmation, but reversed the limitation on the release provisions. It held those provisions applied to all creditors regardless of consent. An appeal to the Sixth Circuit followed.

There were two issues on appeal, one involving the permissibly of non-consensual third party releases in chapter 11 plans, and the other involving the specific classification structure utilized in the plan. Regarding the former, the Sixth Circuit articulated the issue as follows:

> "Does a bankruptcy court have authority to enjoin a non-consenting creditor's claims against a non-debtor to facilitate a reorganization plan under Chapter 11 of the Bankruptcy Code. This is a question of first impression in this Circuit." *Dow Corning*, 280 F.3d at 656.

B. *The Legal Analysis And Reasoning In Dow Corning*

The Court began its analysis by noting that there is no explicit prohibition or authorization in the Bankruptcy Code with respect to the ability of a bankruptcy court "to enjoin a non-consenting creditor's claims against a non-debtor to facilitate a reorganization plan." *Id*.

However, bankruptcy courts are courts of equity "with broad authority to modify creditor-debtor relationships," and the Bankruptcy Code does expressly provide the following statutory authority:

(1) Section 105(a) of the Bankruptcy Code authorizes a bankruptcy court to issue any order, process or judgment that is necessary or appropriate to carry out the provisions of the Bankruptcy Code. This section provides bankruptcy courts with "considerable discretion to approve plans of reorganization." *Id*.

(2) Section 1123(b)(6) allows a plan of reorganization to include any "appropriate provision not inconsistent with the applicable provisions of this title."

Based on these two statutory provisions, the Court concluded that a bankruptcy court "as a forum for resolving large and complex mass litigations, has substantial power to reorder creditor-debtor relations needed to achieve a successful reorganization." *Id*.

As an example of its power in this regard, the Court noted the doctrine of marshaling of assets, under which a bankruptcy court can "order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors." *Id*.

The Court also noted that it is an "ancient but very much alive doctrine" that "a creditor has no right to choose which of two funds will pay his claim." *Id*. "Likewise, when a plan provides for

the full payment of all claims, enjoining claims against a non-debtor so as not to defeat reorganization is consistent with the bankruptcy court's primary function." *Id*.

For all of these reasons, which later cases have referred to as the "residual authority" in the Bankruptcy Code for allowing non-consensual third party releases in chapter 11 plans, the Court held that section 1123(b)(6) authorizes injunctions like these.

The Court rejected the argument that section 524(e) of the Bankruptcy Code prohibits non-consensual third party releases. That section "explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor." *Id*. at 657.

The Court also rejected the argument that these kinds of releases and injunctions exceed the permissible scope of equitable authority that bankruptcy courts are allowed to exercise under section 105(a) of the Bankruptcy Code. *Id*. at 657-658.

Having determined that non-consensual third party releases are not inconsistent with other sections of the Bankruptcy Code, the Court turned to the meat of its analysis and considered when and under what circumstances a non-consensual third party release is an appropriate provision for inclusion in a plan under section 1123(b)(6).

Perhaps the most important sentence in the entire opinion sums it up very succinctly: "Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a non-consenting creditor's claim is only appropriate in 'unusual circumstances.'" *Id*. at 658, citing cases.

The crux of the matter is that there needs to be "unusual circumstances" to permit non-consensual third party releases in a chapter 11 plan, and including such a release provision is a dramatic measure to be used cautiously. To determine whether circumstances are sufficiently "unusual" so as to justify approving such a release provision, the Court looked to a number factors that other circuit courts have considered over the years, and articulated the now oft-cited and well-known seven factor test described below.

Ultimately, after going through and applying each of the seven factors to the facts at issue in *Dow Corning*, the Court found that a number of them were not met and that the circumstances were therefore not unusual enough to justify approving the non-consensual releases contained in Dow's plan. Among other things, the Court found that: (i) as a general matter, the factual findings by the bankruptcy court were conclusory and not sufficiently detailed; (ii) the bankruptcy court's findings regarding how essential the releases were to the plan were ambiguous and inconsistent; and (iii) the bankruptcy court's findings that the governmental creditors in Class 15 would be paid in full were clearly erroneous with regard to the claims of the U.S. As such, the case was remanded to the district court for those matters needing additional factual findings.

C. *The Dow Corning Seven Factor Test*

The Sixth Circuit established the following seven factor test to assess whether sufficiently unusual circumstances are present to justify approving non-consensual third party releases in a chapter 11

plan. Also included below are notes on how the factors have been interpreted and applied in various circumstances by courts within the Sixth Circuit.

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.***

a. To the extent there is any flexibility in the *Dow Corning* factors, the first factor is the "least negotiable" because its focus is essentially jurisdictional. The release must be limited to claims that pose a risk of diminishing the estate. Without a connection to the debtor's estate, there can be no "related to" jurisdiction over the claims to be released. *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 740-741 (Bankr. N.D. Ohio 2019).

b. In the context of director and officer releases, at least one bankruptcy court has held that it is not enough to show that an indemnification agreement exists between the debtor and its directors and officers: "The existence of a common indemnification agreement between a corporation and its directors and officers is not a justification for a non-consensual third party release. Rather, this factor requires that the plan proponent show that there is a real threat to the debtor because such a suit against the third parties 'will deplete the assets of the estate.'" *In re SL Liquidating, Inc.*, 428 B.R. 799, 802 (Bankr. S.D. Ohio 2010).

c. This factor has been expanded by some courts to include situations in addition to indemnity relationships. At least one court found an identity of interests where the debtor's principals were the face of the business and their continued involvement was key to a successful reorganization, among other reasons. *In re K3D Prop. Servs.*, LLC, 635 B.R. 297, 319-320 (Bankr. E.D. Tenn. 2021).

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

a. What does "contributed substantial assets" mean?

(i) Conclusory statements are not enough. The bankruptcy court "must specify facts that support a conclusion that the released parties will make significant contributions to the reorganization pursuant to the Plan." *Dow Corning*, 280 F.3d at 659.

(ii) Postpetition work by directors and officers to draft and negotiate a plan, design and implement a sale process, and conduct business operations was not a contribution of substantial assets. *In re SL Liquidating, Inc.*, 428 B.R. 799, 803 (Bankr. S.D. Ohio 2010).

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.***

a. What does "essential" mean?

(i) In *Dow Corning*, the bankruptcy court found that the releases were essential to the reorganization, but ultimately interpreted the release provisions to apply only to consenting creditors. This implied that the release provisions were not essential as they related to non-consenting creditors. These findings were considered ambiguous and inconsistent as to whether the releases were in fact essential to the plan.

(ii) Releases of directors and officers were not essential in order to avoid "meritless" lawsuits by creditors against the directors and officers. *In re SL Liquidating, Inc.*, 428 B.R. 799, 802-803 (Bankr. S.D. Ohio 2010).

(a) If the lawsuits were meritless, they did not present a true indemnification threat to the debtor.

(b) Claiming that the lawsuits were meritless required the bankruptcy court to rule on the claims in the lawsuits and find that they were indeed meritless. The court did not know if the lawsuits were meritless or not and it would have been procedurally improper to adjudicate the merits of the claims at issue.

(c) It is not uncommon for directors and officers to face lawsuits by creditors. Granting a non-consensual release just because of those lawsuits would risk having requests for such releases become the norm.

(iii) Releases were not essential in the liquidation context. Only a reorganizing debtor needs protection from third party lawsuits that may deplete its assets. *In re SL Liquidating, Inc.*, 428 B.R. 799, 802 (Bankr. S.D. Ohio 2010).

(iv) In the context of governmental claims for environmental cleanup and maintenance obligations, a third party release of claims against non-debtor affiliates was not essential to the Debtor's reorganization where the Debtor itself had direct liability for such claims and voluntarily agreed to assume those claims. *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 741-742 (Bankr. N.D. Ohio 2019).

(v) Third party releases are not essential just because the released parties are providing substantial contributions to fund a plan. Non-debtors should not be able to simply by themselves a non-consensual release without themselves being bankruptcy debtors. Essential means that the third party releases will ensure that the debtor will avoid indirect suits that could frustrate a successful reorganization. *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 742 (Bankr. N.D. Ohio 2019).

4. ***The impacted class has overwhelmingly voted to accept the plan.***

a. What does "overwhelming" acceptance mean?

(i) For a single class of unsecured creditors that accepted a plan by 82% in number and 69% in amount, it was "debatable" whether that acceptance rate was overwhelming since the baseline voting requirement for acceptance under the Bankruptcy Code is one-half in number and two-thirds in amount. *In re SL Liquidating, Inc.*, 428 B.R. 799, 804 (Bankr. S.D. Ohio 2010).

(ii) In the context of governmental claims for environmental cleanup and maintenance obligations, a plan was not overwhelmingly accepted by the governmental creditors who were not involved in the negotiations over the plan and would not receive any consideration for the releases and were not classified under the plan or able to vote on the plan. *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 743 (Bankr. N.D. Ohio 2019).

5. ***The plan provides a mechanism to pay for all, or substantially all, of the class affected by the injunction.***

a. This factor cannot be met simply by showing that distributions under the plan would be more than what creditors would receive under a chapter 7 liquidation. That is nothing more than the usual best interest of creditors test that needs to be met in every confirmation case. *In re SL Liquidating, Inc.*, 428 B.R. 799, 804 (Bankr. S.D. Ohio 2010).

b. A promise by a reorganized and recapitalized debtor to pay unliquidated environmental claims down the line if and when they arise was not a sufficient "mechanism" for payment to governmental creditors. This factor "requires not merely the promise of a feasible reorganization, but rather a special accommodation for the Governments and any other creditors burdened by nondebtor releases being imposed upon them." *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 743-744 (Bankr. N.D. Ohio 2019).

6. ***The plan provides an opportunity for those claimants who choose not to settle to recover in full.***

a. Is this factor applicable only in mass tort cases?

(i) No, it applies in all cases. *In re SL Liquidating, Inc.*, 428 B.R. 799, 804 (Bankr. S.D. Ohio 2010).

(ii) Maybe. Application of the *Dow Corning* factors to situations not involving mass tort claims can be "awkward." In the context of a chapter 9 municipal debt adjustment case, the sixth factor was deemed irrelevant to the case, and third party releases were approved where every other *Dow Corning* factor weighed so heavily in favor of approval. *In re City of Detroit*, 524 B.R. 147, 175 (Bankr. E.D. Mich. 2014).

7. ***The bankruptcy court made a record of specific factual findings that support its conclusions.***

a. Conclusory statements and ambiguous findings are not sufficient. There needs to be an explanation or discussion of the evidence underlying the court's factual findings, and the findings need to discuss the facts as they relate specifically to the released parties. *Dow Corning*, 280 F.3d at 658.

b. This factor need not be considered in the context of determining whether a disclosure statement should be denied approval where the plan is patently unconfirmable due to the existence of non-consensual third party releases. The court treats the analysis under a Rule 12(b)(6) standard and addresses it purely as a matter of law. *In re FirstEnergy Solutions Corp.*, 606 B.R. 720, 745 (Bankr. N.D. Ohio 2019).

D. Are All Seven Factors Needed In Every Case?

The Sixth Circuit has not expressly weighed in on the applicability of the seven factors to cases outside the context of mass tort and product liability cases. Although, it is noteworthy that the Sixth Circuit later characterized its holding in Dow Corning in a way that might suggest all seven factors are needed in every case: "We held that such an injunction is permissible, but instructed that it is appropriate only in 'unusual circumstances,' which can be found when seven factors are present." *Papas v. Buchwald Capital Advisors, LLC (In re Greektown Holdings, LLC)*, 728 F.3d 567, 576 (6th Cir. 2013).

The one thing that is clear though is the Sixth Circuit's requirement that "unusual circumstances" be present in order to justify such extraordinary and rare relief. Non-consensual third party releases are the exception, not the rule.

Lower courts within the Sixth Circuit have varied on this question.

- **No**. "Some courts have, however, tailored the seven *Dow Corning* elements to suit the needs of the case and have not required satisfaction of all seven factors … It must be recognized that the *Dow Corning* holding is in the context of a chapter 11 business reorganization of a debtor beset by mass tort claims. Its direct application in a chapter 9 municipal debt adjustment case is therefore awkward and uncertain. Much debate could be had regarding which of the *Dow Corning* factors should apply in a chapter 9 case and whether any other factors should apply." *In re City of Detroit*, 524 B.R. 147, 174 (Bankr. E.D. Mich. 2014). The Court ultimately held that it was unnecessary to determine whether the factor requiring payment in full to non-consenting creditors applied because "…it concludes that the other *Dow Corning* factors weigh so heavily in favor of approving the releases that it is appropriate to do so even if this element is not met." *Id*. at 175.

- **Yes**. "The varying positions of the parties as to which factor may be the most important reinforces this Court's interpretation of *In re Dow Corning* that, at least in the Sixth Circuit, all of the factors must be present and all the factors are important." *In re SL Liquidating, Inc.* 428 B.R. 799, 802 (Bankr. S.D. Ohio 2010).

Some courts outside of the Sixth Circuit have viewed the seven factor test as a non-exclusive list of considerations to be applied flexibly.

- *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying (In re Seaside Eng'g & Surveying)*, 780 F.3d 1070, 1079 (11th Cir. 2015): Under the *Dow Corning* test, bankruptcy courts have discretion to determine which of these factors will be relevant in each case. "The factors should be considered a non-exclusive 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."

E. Does The Dow Corning Test Apply Outside Of A Plan Context?

The Sixth Circuit has held that the seven-factor *Dow Corning* test is not applicable to situations involving a post-confirmation settlement involving a potential bar order against third party claims. *Papas v. Buchwald Capital Advisors, LLC (In re Greektown Holdings, LLC)*, 728 F.3d 567, 576 (6th Cir. 2013). "Furthermore, this case involves a bar order entered in connection with a settlement agreement long after the plan of reorganization was confirmed, whereas [*Dow Corning*] involved an injunction incorporated into a plan of reorganization. Due to this distinction, the seven-factor test we applied in [*Dow Corning*] provides little help in determining whether the bar order here was proper." *Id*. Ultimately, the Sixth Circuit held, among other things, that the district court did not have subject matter jurisdiction over the third party claims at issue under the "related to" standard because a dispute cannot affect the administration of a bankruptcy case once a plan has been confirmed. *Id*. at 577-578.

Conclusion

In summary, a chapter 11 plan can include non-consensual third party releases under Sixth Circuit law only in unusual circumstances where the seven factors articulated in *Dow Corning* are met. Whether all seven factors need to be met in every situation or there is room for the flexible

application of those factors remains unsettled. There have been limited instances where lower courts inside and outside of the Sixth Circuit have taken the approach of flexibility in applying the factors as needed to establish unusual circumstances. The precise contours of the factors and how they are applied in different situations continues to be developed in the case law. Practitioners in the Sixth Circuit need to be mindful of the requirement to meet the *Dow Corning* test, as well as the areas that may remain open to interpretation or argument in applying the test, in negotiating plans that include non-consensual third party releases. Such provides are the exception, not the rule, and will be granted only in truly unusual circumstances.

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