NONDEBTOR RELEASE PROHIBITION ACT OF 2021 ("NRPA"): NOT THE BEST SOLUTION TO THE ABUSE OF NON-CONSENSUAL THIRD-PARTY RELEASE

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ABSTRACT

Since 1978, bankruptcy courts have been tasked with trying to adjudicate intractable issues in the insolvency of businesses and individuals. The fundamental goal of Chapter 11 reorganization is to give debtors a financial "fresh start" unhampered by the pressure and discouragement of preexisting debt. This goal is largely achieved through the rearrangement of the debtor's capital structure, and to come up with a plan of repayment that conclusively releases the debtor from all outstanding claims of liabilities against it. Over the years of development, this mechanism has expanded to release the debtor's third-party affiliates, including shareholders, officers, and insurance carriers, from their liabilities arising out of the debtor's reorganization. Due to its effectiveness in facilitating business revival, this so-called "third-party release" mechanism has become one of the most leveraged reorganizational tools in Chapter 11 cases. Bankruptcy courts normally allow third-party releases that obtain full creditors' approval. On the other hand, non-consensual third-party releases, which are not agreed upon by all creditors, are subject to the bankruptcy courts' higher standard of scrutiny. However, recent controversies concerning the abuse of non-consensual third-party release brought sound criticisms that question some jurisdictions' relatively permissive attitude toward such releases.

In 2021, the Nondebtor Release Prohibition Act of 2021 (NRPA) was proposed in Congress. The Act would impose a blanket prohibition to the use of non-consensual third-party release in virtually all bankruptcy cases, except for asbestos-related debtors subject to 11 U.S.C. § 524(g). This would also signal an end to the ongoing development among federal circuit courts in deciding the appropriate scope of application of one of the most prevalent bankruptcy law mechanisms. This note argues why NRPA's abrupt prohibition against the use of non-consensual third-party release could seriously hamper the bankruptcy courts' capability in facilitating a successful business reorganization, which run contrary to the fundamental goals of the United States bankruptcy law regime. This Note will also propose an alternative route that Congress should take in resolving issues concerning the abuse of non-consensual third-party releases.

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I. INTRODUCTION

A. What is Non-Consensual Third-Party Release?

Chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code") provides for reorganization, which allows a debtor to restructure its businesses while remaining in operation.[1] Under this chapter, a debtor may propose to the bankruptcy court a plan of reorganization, which outlines how the debtor will fulfill its outstanding obligations it owes to creditors.[2] Since most reorganization plans vastly modify the existing rights and responsibilities between the debtor and its creditors, creditors whose rights are affected are allowed to express their opinions by voting for or against the plan.[3] Bankruptcy court may confirm the plan if it obtains the approval of a sufficient number of creditors and satisfies certain legal requirements.[4] Upon the court's confirmation of its reorganization plan, the debtor is discharged from all pre-confirmation liabilities unless the confirmation is revoked by the court.[5]

Third-party release is an extension of this rehabilitative feature of the Bankruptcy Code. Upon the confirmation of the debtor's reorganization plan, a third-party release provision conclusively discharges a bankrupted debtor's non-debtor affiliates from creditor's further claims.[6] Non-debtor affiliates may include

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[1] *See Chapter 11 - Bankruptcy Basics*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics [https://perma.cc/NLY6] (last visited Mar. 2, 2023).
[2] *See* Karra Kingston, *What is A Chapter 11 Reorganization Plan?*, UPSOLVE, (July 21, 2020), https://upsolve.org/learn/reorganization-plan/ [https://perma.cc/S9AP-5QQ6].
[3] *See id.*
[4] *See Chapter 11 - Bankruptcy Basics*, *supra* note 1.
[5] *See* 11 U.S.C. § 1141(d)(1).
[6] *See* Tyler Layne, *Constitutionality of Non-Consensual Third-Party Releases in Bankruptcy Reorganization*, BLOOMBERG L. (Nov. 2021), https://www.bloomberglaw.com/product/health/document/X42S2V68000000?re

parties who could assert post-confirmation indemnification claims against the debtor or are potential sources of funding for the reorganization plan, including co-debtors, majority shareholders, officers, or the debtor's insurance carriers.[7] Problems may arise if there are creditors who strongly disagree with the third-party release due to the possibility of future claimants coming forward against the debtor, representing third-parties who are never afforded a chance to vote on the plan.[8] The expansive scope and "non-consensual" characteristic of such third-party release draws much criticism as to its legitimacy.[9] The use of a third-party release can be even more controversial when debtors and third parties are discharged from tort liabilities.[10]

The U.S. Bankruptcy Court for the District of Delaware's 2020 confirmation of the Boy Scouts of America's reorganization plan is one example of the long-debated use of non-consensual third-party release in bankruptcy proceedings.[11] On February 18, 2020, the Boy Scouts of America filed for Bankruptcy under Chapter 11 in the face of enormous allegations concerning serious sexual misconduct.[12] Boy Scouts of America identified itself as facing approximately 275 pending lawsuits in state and federal courts across the nation, and an estimated 1,400 potential claims to be filed against it.[13] After spending more than $150 million on settlements and legal fees from 2017 through 2019, Boys Scouts of America realized that the pursuit of case-by-case tort litigation was not financially practical.[14] The concerns were valid. Following Boy Scouts of America's bankruptcy filing, more than 82,200 abuse

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[7] *See id.*

[8] *Nonconsensual Third-Party Releases: What They Are and Why You Should Care*, BRADLEY ARANT BOULT CUMMINGS LLP (Mar. 15, 2022), https://www.bradley.com/insights/publications/2022/03/nonconsensual-third-party-releases-what-they-are-and-why-you-should-care [https://perma.cc/G8U8-NEH8].

[9] *See* Lane, *supra* note 6.

[10] *See id.*

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

[12] Laura Ly, *Boy Scouts of America Files for Bankruptcy. Hundreds of Sexual Abuse Lawsuits Are Now on Hold*, CNN (Feb. 18, 2020, 9:33 AM), https://www.cnn.com/2020/02/18/us/boy-scouts-bankruptcy/index.html [https://perma.cc/Z6Z4-7B5W].

[13] *See* Debtor's Informational Brief at 3, *In re* Boy Scouts of Am. and Delaware BSA, LLC, 642 B.R. 504 (Bankr. D. Del 2022) (No. 20-10343).

[14] *See id.* at 5-6.

claims against it emerged—far greater than its initial forecast.[15] On July 29, 2022, U.S. Bankruptcy Court for the District of Delaware approved most of Boy Scouts of America's reorganization plan, including a $2.6 billion bulk settlement with the 82,000 victims who were sexually abused during their past participation in the organization's scout activities.[16] The court approved the settlement amount on the ground that it exceeded expert valuations on the aggregated value of abuse claims.[17] In addition, creditors, who are tort claimants in the sexual abuse allegations against Boy Scouts of America, are conclusively deemed to have agreed to the release unless they affirmatively "opt-out."[18]

According to the settlement plan, all claims and compensations related to scout sexual abuses will be channeled through a trust set up by the debtor.[19] However, controversies of the plan came from its release of liabilities of non-debtor third-party who contributed to the trust. Of the $2.279 billion initial funding to the trust, Boy Scouts of America, the bankrupted debtor, will only itself contribute a total of $78.2 million.[20] In comparison, non-bankrupted affiliated third parties like local Boy Scouts councils and settling insurers will contribute $515 million and $1.656 billion respectively.[21] United Methodist Church will also contribute $30 million due to its contractual affiliation with Boy Scout of America.[22] All of these contributors will be released from any future scouting-related abuse claims, hence effectively avoiding individual legal claims from non-consenting claimants.[23]

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[15] Randall Chase, *Ruling Leaves Questions About Boy Scouts Bankruptcy Plan*, ASSOCIATED PRESS (July 29, 2022, 11:28 PM), https://apnews.com/article/lawsuits-delaware-sexual-abuse-dover-8fcfc4db841337ddfadc181b9840fd06 [https://perma.cc/XB8B-G388].

[16] *See In re Boy Scouts of Am.*, 642 B.R. at 561 (approving a settlement trust contributed by noncontingent funding of $2,484,200,000 and an additional $200 million contingent funding).

[17] *See id.* at 553-60.

[18] *Third-Party Releases: A New Normal in Chapter 11 Plans?*, HIRSCHLER FLEISCHER (May 4, 2021), https://www.hirschlerlaw.com/newsroom-publications-chapter-11-third-party-releases [https://perma.cc/FLG3-K5EL].

[19] *See In re Boy Scouts of Am.*, 642 B.R. at 608.

[20] *See id.* at 561.

[21] *See id.* Under the plan, Boy Scouts of America's largest insurers, Century Indemnity and The Hartford, will contribute $800 million and $787 million respectively. *See id.* at 564-65. Other insurers, including the primary policies insurer to local councils, will contribute a total of roughly $69 million. *See id.* at 566-67.

[22] *See id.* at 604-05.

[23] *See In re Boy Scouts of Am.*, 642 B.R. at 586-87.

B. The first use of non-consensual third-party release in bankruptcy court and why it became preferable in long tail mass tort bankruptcies.

Largely due to its receptiveness to non-consensual third-party release, bankruptcy court has evolved as the forum of choice for entities seeking to resolve mass tort litigations against them. It started with the Chapter 11 filings of Johns-Manville Corporation, a manufacturer of asbestos that was commonly used in construction but was later found to have posed serious health hazards to those exposed to it.[24] Expecting a proliferation of personal injury claims over the next decades, the Fortune 500 corporation hoped to leverage the bankruptcy protections to settle not only lawsuits already pending against them, but also future claims by claimants who may not yet be aware of their entitlement to recourse "due to the latency period of many years characterizing manifestation of all asbestos related diseases."[25] In response, the bankruptcy court made an unprecedented ruling that the unidentified "future claimants" could be regarded as parties in interest to Johns-Manville's reorganization proceedings, pursuant to the "broad, flexible definition" under 11 U.S.C. § 1109.[26] The Second Circuit later approved the reorganizational plan for Johns-Manville to set up an Asbestos Health Trust, funded with the entity's assets such as cash, receivable, insurance settlements to satisfy both present and future tort claimants.[27] All present and future claims were thus directed against the trust from the Johns-Manville operating entities to ensure the successfulness of the entity's reorganization. [28]

The trust/injunction mechanism in the Johns-Manville reorganization was proven favorable by other asbestos-related bankrupted debtors who were identically situated, and they started to implement similar arrangements. [29] Bankruptcy courts thus became a preferred venue to resolve "long-tail" mass torts cases in which suits for damages arise long after the tortious conduct

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[24] *See In re* Johns-Manville Corp., 36 B.R. 743, 745 (Bankr. S.D.N.Y. 1984); *see also In re* UNR Indus., Inc., 45 B.R. 322, 326 (N.D. Ill. 1984) (affirming bankruptcy court's statutory authority to estimate mass tort claims for the purpose of confirming a bankruptcy plan).

[25] *In re Johns-Manville Corp.*, 36 B.R. at 745.

[26] 11 U.S.C.A. § 1109(b) (West) (defining a party in interest as someone who may raise, appear, and be heard on any issue in a case under Title 11); *In re Johns-Manville Corp.*, 36 B.R. at 749.

[27] *See* Kane v. Johns-Manville Corp., 843 F.2d 636, 650 (2d Cir. 1988).

[28] *See id.* at 640.

[29] *See* Joshua M. Silverstein, *Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies*, 78 UMKC L. REV. 1, 19 (2009).

occurred.[30] Given the characteristics of such claims, long-tail mass tort litigation can place an "enormous burden" on the defendant entity and the judiciary system, which in turn threatens the defendant's going concern and adequate compensation for the victims.[31] Since the primary goal of tort proceedings is to grant the plaintiff compensatory relief that is commensurate to the individual injuries suffered, the court may give no consideration to the defendant's ability to pay.[32] The "long-tail" adds even more uncertainty to the total amount of compensation due to the unidentified number of claimants and the increasingly extensive time span as cases amount.[33]

In comparison, bankruptcy courts tend to strike a balance between awarding creditors (tort claimants) reasonable compensation and affording defendant companies a chance to regain business momentum.[34] Firstly, bankruptcy courts are authorized to estimate any factors that may unduly delay the administration of the case.[35] Bankruptcy courts have thus developed a way of claim estimation by statistically analyzing the potential numbers, types, and damages of the claims the debtor expects to face.[36] Based on the reliable estimation of potential claims, the debtor will make a contribution of adequate capital into a trust that ensures both present and future claimants may receive a certain level of compensation. By setting up a trust, the debtor can then shield themselves from further claims and focus its resources on business revitalization.[37] In fact, the compensation of future claimants at times relies on the success of the debtor's plan of reorganization, since a debtor may be allowed to compensate tort claimants through future earnings from its on-going operation.[38] For example, in the case of *Johns-*

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[30] *See* Kenneth S. Abraham, *The Long-Tail Liability Revolution: Creating the New World of Tort and Insurance Law*, 6 U. PA. J.L. & PUB. AFFS. 347, 349 (2021).
[31] Alan N. Resnick, *Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability*, 148 U. PA. L. REV. 2045, 2045 (2000).
[32] *Id.* at 2049.
[33] *Id.* at 2045 (discussing how "thousands of future claimants [in mass torts actions] . . . will first discover their injuries in decades to come" which gives rise to a "practical inability to provide each tort victim with traditional, individualized adjudication under the usual rules of litigation").
[34] *Id.* at 2050.
[35] 11 U.S.C. § 502(c)(1).
[36] *See In re* Garlock Sealing Techs., LLC, 504 B.R. 71, 94-97 (Bankr. W.D.N.C. 2014).
[37] *See* Frederick Tung, *The Future Claims Representative in Mass Tort Bankruptcy: A Preliminary Inquiry*, 3 CHAP. L. REV. 43 (2000).
[38] SARAH ELIZABETH GIBSON, JUDICIAL MANAGEMENT OF MASS TORT BANKRUPTCY CASES 1 (2005).

Manville, the court-established trust had been partially funded by stock of the reorganized Johns-Manville Corporation and up to 20% of the reorganized entity's annual earnings for as long as it took to satisfy all tort claims.[39] Yet, one the most evolutionary measures in the Johns-Manville reorganization was its settlement with the company's insurers, who were allowed to collectively contribute $770 million into the trust in exchange for release from claims arising out of or relating to their coverage of Johns-Manville.[40] This marks the first appearance of non-consensual third-party release in the history of bankruptcy law.[41]

C. Legitimacy in non-consensual third-party release: its codification in 11 U.S.C § 524(g) and divided interpretation among Federal Circuits.

Eventually, Congress stepped in to enact the Bankruptcy Reform Act of 1994.[42] Subsection (g) was added to 11 U.S.C § 524 to establish a codified procedure for dealing with future personal injury claims against asbestos manufacturers.[43] This subsection was modeled on Johns-Manville and UNR Industry's trust/injunction mechanism.[44] Subsection (g) allows bankruptcy courts to issue injunctions to enjoin entities from taking legal action for the purpose of collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust.[45] Congress made it clear that its intent was to "strengthen the Manville and UNR trust/injunction mechanisms and to offer similar certitude to other asbestos trust/injunction mechanisms that meet the same kind of high standards with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases."[46]

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[39] *See* Kane v. Johns-Manville Corp., 843 F.2d 636, 640 (2d Cir. 1988).
[40] *See* MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 90 (2d Cir. 1988).
[41] Silverstein, *supra* note 29, at 3 (citing STEPHEN J. CARROLL ET AL., ASBESTOS LITIGATION 110-11 (RAND Inst. for Civ. Just. 2005)).
[42] Pub. L. No. 103-394, 108 Stat. 4106 (1994); *see also* Robin E. Phelan et al., *1994 Consumer Bankruptcy Developments: The Bankruptcy Reform Act of 1994*, 50 BUS. LAW. 1193, 1193 (1995).
[43] *See* 11 U.S.C. § 524(g).
[44] Sander L. Esserman & David J. Parsons, *The Case for Broad Access to 11 U.S.C. § 524(f) in Light of the Third Circuit's Ongoing Business Requirement Dicta in Combustion Engineering*, N.Y.U. ANN. SURV. OF AM. L. 187, 191 (2006).
[45] *See* 11 U.S.C. § 524(g)(1)(B).
[46] 140 CONG. REC. 20, 27692 (1994) (statement of Rep. Brooks) ("The Committee has approved section 111 of the bill in order to strengthen the Manville and UNR trust/injunction mechanisms and to offer similar certitude to other asbestos trust/injunction mechanisms that meet the same kind of high

Explicitly, 11 U.S.C § 524(g)(4) permits third-party release as long as certain requirements are met.[47] This was the first time where the bankruptcy court's unique use of non-consensual third-party release is codified and legitimized.[48]

A close look into the legislative history indicated that the mechanism established in subsection (g) is available for use by "any asbestos company facing a similarly overwhelming liability."[49] For some, this reflects the fact that Congress "believed that Section 524(g) created an exception to what would otherwise be the applicable rule of law."[50] However, others who desire to apply the releases to non-asbestos cases argue that, although 524(g) is exclusively applicable to asbestos-related bankruptcies, it nevertheless demonstrated the legitimacy of the third-party release mechanism in bankruptcy courts.[51] The source of the courts' jurisdiction is 28 U.S.C. § 157, under which bankruptcy judges are authorized to "hear and determine all cases under title 11 and all core proceedings arising under title 11."[52] Bankruptcy courts may also hear non-core proceedings "that are otherwise related to a case under Title 11."[53] For most courts, non-core bankruptcy proceedings are construed as those resolving issues "related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action…and which in any way impacts upon the handling and administration of the bankrupt estate."[54] Bankruptcy courts thus can apply non-consensual third-party releases in non-asbestos cases by relying on the power granted by 11 U.S.C. § 105, which allows bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[55] This grant of power has given bankruptcy courts the

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standards with respect to regard for the rights of claimants, present and future, as displayed in the two pioneering cases. The Committee believes Johns-Manville and UNR were aided in meeting these high standards, in part at least, by the perceived legal uncertainty surrounding this mechanism, which created strong incentives to take exceptional precautions at every stage of the proceeding. The Committee has concluded, therefore, that creating greater certitude regarding the validity of the trust/injunction mechanism must be accompanied by explicit requirements simulating those met in the Manville case.").

[47] *See* 11 U.S.C. § 524(g)(4)(ii).

[48] Esserman & Parsons, *supra* note 44, at 189-90.

[49] H.R. REP. NO. 103-835, at 41 (1994).

[50] *In re* Purdue Pharma, L.P., 635 B.R. 26, 92 (S.D.N.Y. 2021), *rev'd*, 69 F.4th 45 (2d Cir. 2023).

[51] *See, e.g.*, *In re* Purdue Pharma, L.P., 69 F.4th 45, 76 (2d Cir. 2023); *In re* Boy Scouts of Am. & Delaware BSA, LLC, 650 B.R. 87, 137 (D. Del. 2023).

[52] 28 U.S.C. § 157(b)(1).

[53] 28 U.S.C. § 157(c)(1).

[54] *In re* Fietz, 852 F.2d 455, 457 (9th Cir. 1988).

[55] 11 U.S.C. § 105(a).

flexibility to facilitate critical reorganization measures, including third-party release, so as to vitiate the longstanding bankruptcy policy of favoring settlements over interminable value-destructive litigation.[56]

The legitimacy in the extended application of third-party release to non-asbestos entities draws harsh debates and caused a circuit split that has continued to this day.[57] For circuits allowing non-consensual third-party release, third parties affiliated with the bankrupted entities — co-debtors, insurers, subsidiaries, or even the debtor's officers, directors, or employees — may be allowed to make contributions to the settlement trust in exchange for the same dischargement when the release is "both necessary [to ensure the success of the debtor's reorganization] and given in exchange for fair consideration."[58] The Third Circuit, which reviews cases appealed from the U.S. Bankruptcy Court for the District of Delaware, has been leaving the door open for third-party release in mass tort bankruptcies.[59]

D. Congress's attempt to resolve the circuit split on the use of non-consensual third-party release: the Nondebtor Release Prohibition Act of 2021

The Circuit splits on the use of non-consensual third-party release continued as Congress responded to the high-profiled bankruptcy of Purdue Pharma L.P. ("Purdue").[60] In 2007, Purdue pled guilty to its false marketing of OxyContin, an opioid pain reliever that led to life-threatening addiction and numerous

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[56] *Congressional Committees Propose Changes to Bankruptcy Code Prohibiting Non-Consensual Releases of Third Parties and Limiting Other Important Bankruptcy Tools*, GIBSON DUNN (Aug. 2, 2021), https://www.gibsondunn.com/congressional-committees-propose-changes-to-bankruptcy-code-prohibiting-non-consensual-releases-of-third-parties-and-limiting-other-important-bankruptcy-tools/ [https://perma.cc/2VST-GSPZ].

[57] The First, Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits may approve non-consensual third-party release on a case-by-case basis, albeit under different standards. The Fifth, Ninth, and Tenth Circuits, on the other hand, outright forbid debtor's proposals of such release under Chapter 11.

[58] *In re* Genesis Health Ventures, Inc., 266 B.R. 591, 607 (Bankr. D. Del. 2001) (quoting *In re* Continental Airlines, 203 F.3d 203, 211 (3d Cir. 2000)).

[59] *See In re* Millennium Lab Holdings II, LLC, 945 F.3d 126, 135 (3d Cir. 2019) (upholding bankruptcy court's constitutional authority to confirm plans involving third-party release that were "integral to the restructuring of the debtor-creditor relationship").

[60] *The Role of Purdue Pharma and the Sackler Family in the Opioid Epidemic: Hearing Before the H. Comm. on Oversight and Reform*, 116th Cong. (2020).

overdoses.[61] In order to resolve both pending and future claims related to the OxyContin-related claims, Purdue filed for Chapter 11 protection in September 2019.[62] Two years after Purdue filed bankruptcy, the U.S. Bankruptcy Court for the Southern District of New York ("SDNY") approved Purdue's reorganization plan, which included a broad release of liability for not only Purdue but also its owner, the Sackler family and their affiliates — none of whom is a debtor in the bankruptcy case.[63] The public expressed dissent toward the decision when it was revealed that the Sackler family, prior to the Chapter 11 proceedings, had repositioned huge proportions of Purdue's assets to the family's offshore entities or spendthrift trusts.[64] By moving the assets to non-debtor entities that joined the release, the Sackler family were able to enjoy the benefits of the release from liability without taking commensurate responsibilities under the Chapter 11 proceedings.[65] Over the years, the use of third-party release has been increasing in complexity, and the debates over its legitimacy have intensified. However, it wasn't until the case of Purdue and the Sackler family that the public became aware of the possible malicious intent within certain tactical use of third-party release.

In 2021, in response to public outrage against inequitable use of third-party release to shield legal liabilities, Democratic members of Congress introduced the Nondebtor Release Prohibition Act of 2021 (the "NRPA"), which aims to impose a blanket prohibition on "non-consensual release of a non-debtor entity's liability to an entity other than the debtor" in any bankruptcy proceedings.[66] The bill is

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[61] United States v. Purdue Frederick Co., 495 F.Supp.2d 569, 572, 576 (W.D. Va. 2007); Barry Meier, *In Guilty Plea, OxyContin Maker to Pay $600 Million*, N.Y. TIMES (May 10, 2007), https://www.nytimes.com/2007/05/10/business/11drug-web.html [https://perma.cc/2CAK-2785].

[62] *In re* Purdue Pharma L.P., 633 B.R. 53, 59 (S.D.N.Y. 2021); Berkeley Lovelace Jr., *OxyContin Maker Purdue Pharma Files for Bankruptcy Protection*, CNBC (Sept. 16, 2019, 11:29 PM), https://www.cnbc.com/2019/09/16/oxycontin-maker-purdue-pharma-files-for-bankruptcy-protection.html [https://perma.cc/HP6C-BPYJ].

[63] *See In re Purdue Pharma L.P.*, 633 B.R. at 59, 115.

[64] *In re Purdue Pharma L.P.: S.D.N.Y. Holds Bankruptcy Court Lacks Statutory Authority to Approve Sackler Family Releases*, VINSON & ELKINS: INSIGHTS (Dec. 28, 2021), https://www.velaw.com/insights/in-re-purdue-pharma-l-p-s-d-n-y-holds-bankruptcy-court-lacks-statutory-authority-to-approve-sackler-family-releases/ [https://perma.cc/CK9M-FQKH].

[65] *See* Jacob Hedgpeth, Note, *The Bankruptcy of Purdue Pharma in the Wake of Big Tobacco*, 94 UNIV. COLO. L. REV. F. 33, 35-36 (2023).

[66] H.R. 4777, 117th Cong. (1st Sess. 2021).

currently being considered in the U.S. House of Representatives.[67] There have been no actions on the Senate version of the bill since it was introduced to the U.S. Senate in July 2021.[68] The proposed bill generally prohibits a bankruptcy court from (1) releasing or modifying a non-debtor's liability through the approval of a bankruptcy plan or through an order, or (2) enjoining a judicial proceeding or other act to collect or otherwise enforce such a claim or cause of action against a non-debtor, unless the affected claimants give express consent or the case is subject to § 524(g)(4) asbestos exception.[69] In introducing the bill, House Committee on Oversight and Reform Chairwoman Carolyn B. Maloney prided it as a "critical tool to prevent bad actors, like the Sacklers, from abusing a loophole in the Bankruptcy Code to escape personal responsibility for their actions."[70] House Judiciary Committee Chairman Jerrold Nadler further commented when the Committee passed the bill that "the bankruptcy system is supposed to work for everyone, but in many cases, it works only for big corporations and the very wealthy who have figured out how to exploit the system to obtain blanket immunity for their wrongdoing."[71]

Nevertheless, the bill, if passed, could radically diminish the authority of the U.S. bankruptcy courts. As mentioned, a broader reading of 28 U.S.C. § 157 can establish a much more liberal delineation of bankruptcy courts' jurisdiction under Chapter 11, thus affording bankruptcy courts much-needed flexibility to resolve deadlocked legal relationships between debtors and creditors.[72] The use of non-consensual third-party release is based on such permissive readings of bankruptcy laws.[73] Hence, the adoption of a blanket prohibition imposed by the NRPA would not only put an end to the non-consensual third-party release mechanism, but also direct the courts to construe 28 U.S.C. § 157 and Chapter 11 provisions narrowly, resulting in sweeping restraints to the bankruptcy court's ability to resolve conflicts in bankruptcy proceedings. This Note seeks to explain why the NRPA is not an

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[67] *See H.R.4777 - Nondebtor Release Prohibition Act of 2021*, CONGRESS.GOV, https://www.congress.gov/bill/117th-congress/house-bill/4777/all-actions-without-amendments [https://perma.cc/WT6X-NJKV] (last visited Feb. 2, 2024).
[68] *See* S. 2497, 117th Cong. (2021).
[69] *See* H.R. 4777, *supra* note 66.
[70] *House Judiciary Committee Passes Nondebtor Release Prohibition Act*, COMM. ON OVERSIGHT & ACCOUNTABILITY DEMOCRATS (Nov. 3, 2021), https://oversight.house.gov/news/press-releases/house-judiciary-committee-passes-nondebtor-release-prohibition-act [https://perma.cc/2MND-VQD2].
[71] *Id.*
[72] 28 U.S.C. § 157; *see also In re* Fietz, 852 F.2d 455, 457 (9th Cir. 1988).
[73] BRADLEY ARANT BOULT CUMMINGS LLP, *supra* note 8.

ideal response to non-consensual third-party release controversies, and to propose an alternative solution.

II. ANALYSIS

A. Instead of eliminating non-consensual third-party release outright, there are better alternatives to fix the abuse of this important tool in bankruptcy proceedings.

i. There is no pressing need to deprive bankruptcy courts' authority to confirm non-consensual third-party release which has been sufficiently limited by judicial review.

Congress's imposition of a blanket prohibition on non-consensual third-party release is not a direct tackle, but an outright avoidance of the problems associated with the abuse of this reorganization mechanism. First, the use of non-consensual third-party release in Chapter 11 reorganization is obviously not without merit. If Congress truly believes that the current non-consensual third-party release mechanism left too large of a loophole that such releases should be wholly banned, then it makes no sense that NRPA still makes exceptions for asbestos-related bankruptcies subject to 11 U.S.C § 524(g).[74] As mentioned earlier in this note, public outrage over the bankruptcy court's decision in *Purdue* played an obvious part in propelling the Congress to propose the NRPA.[75] In that case, criticism is mainly directed toward the bankruptcy courts' overly broad discretion in qualifying the Sackler family as a related third-party, but not toward its application to other third-parties who are closely related to Purdue Pharma's bankruptcy.[76] That is to say, the real issue at hand is not whether non-consensual third-party release should be abrogated, but how to define its legitimate scope of application. Therefore, Congress could have solved the controversies by taking a more active role in delineating the bankruptcy courts' permissible application of non-consensual third-party release provisions. For example, Congress may place additional checks and balances systems to restrain a bankruptcy

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[74] Nondebtor Release Prohibition Act of 2021, H.R. 4777, 117th Cong. § 113 (2021); 11 U.S.C. § 524(g); Press Release, House Committee on Oversight & Reform, House Judiciary Committee Passes Nondebtor Release Prohibition Act (Nov. 3, 2021) https://oversight.house.gov/news/press-releases/house-judiciary-committee-passes-nondebtor-release-prohibition-act [https://perma.cc/R69L-DZE6].

[75] Press Release, *supra* note 74.

[76] *Id.*

court's discretion in deciding on the applicability of non-consensual third-party releases. Congress may also settle the fundamental question of under what circumstances the use of such releases can be justified. So, the question is: does Congress really have to go to the extreme in eliminating the bankruptcy courts' discretion once and for all?

The answer is probably not, since the bankruptcy courts' discretion in deciding on the application of third-party releases is already under stringent scrutiny.[77] Judicial review is among one of the most efficient mechanisms in limiting bankruptcy courts' decisions in place.[78] Fundamentally, the bankruptcy court is a subsidiary unit and under the control of the district court.[79] The Bankruptcy Amendment and Federal Judgement Act of 1984 explicitly vested the district court with original and exclusive jurisdiction of all cases under Title 11, and also original, but not exclusive, jurisdiction of all civil proceedings arising under Title 11.[80] District courts may refer cases under Title 11 and proceedings arising under Title 11, or cases arising in or related to a case under Title 11 to bankruptcy judges for the district.[81] Hence, not only can the district courts decide what proceedings the bankruptcy court can hear, they may also withdraw, in whole or in part, any cases of proceedings referred.[82] District courts also have the power to appoint bankruptcy judges, though the selection process differs between each district.[83] To tackle the issues presented in *Purdue* or in similar cases, Congress could have simply improved the current checks and balances without frustrating the benefits in non-consensual third-party releases.

Perhaps even more importantly, even after the referred cases are decided by bankruptcy courts, district courts retain the authority to conduct de novo review and to enter final orders under Federal Bankruptcy Rules.[84] Therefore, when a district court determines that a bankruptcy court lacks constitutional reasoning in confirming a third-party release, it can treat bankruptcy court final orders as merely finding of facts and enter new judgment.[85] In fact, after the

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[77] *In re* Purdue Pharma, L.P., 635 B.R. 26, 79 (S.D.N.Y. 2021).
[78] Stern v. Marshall, 564 U.S. 462, 475 (2011).
[79] 28 U.S.C. § 158(a)(3).
[80] 28 U.S.C. § 1334(a)-(b).
[81] 28 U.S.C. § 157(a).
[82] 28 U.S.C. § 157(d).
[83] 28 U.S.C. § 152(a)(1).
[84] 28 U.S.C. § 157(c)(1).
[85] The Bankruptcy Rule provides that "[i]f, on appeal, a district court determines that the bankruptcy court did not have the power under Article III of the Constitution to enter the judgment, order, or decree appealed from, the district

proposal of NRPA, the SDNY overruled on appeal the bankruptcy court's order in *Purdue* and thus dismissed the bankruptcy court's judgment on the necessity to injunct third parties like Sackler, the very case that brought about the proposal of the NRPA.[86] Conclusively, bankruptcy courts are under the effective means of control by the federal courts of their respective districts. Unless there is evidence that courts fail to fulfill their gatekeeping duties, there is no pressing need for Congress to impose a strict restraint on non-consensual third-party release just for the purpose of restricting bankruptcy courts' discretion.

ii. The Circuit split on the standard of non-consensual third-party releases application continues to narrow, which makes it harder for potential abusers of the release mechanism to forum shop for "loopholes"

Those skeptical of the use of non-consensual third-party release not only criticize the unreliability in bankruptcy court discretion, but also argue that the federal circuit splits on non-consensual third-party release allows those who want to escape personal liabilities, like the Sackler family, to forum shop for loopholes.[87] They thus welcome NRPA to eliminate the use of non-consensual third-party release.[88] Admittedly, it is the ambiguous statutory language that led to continuous debate and circuit splits over the scope of bankruptcy court jurisdiction, and ultimately bankruptcy courts' authority to decide on non-consensual third-party release provisions.[89] However, to implement the blanket prohibition in NRPA is undoubtedly throwing away the apple because of the core. If Congress wishes to fundamentally resolve the

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court may treat it as proposed findings of fact and conclusions of law." *See* Fed. R. Bankr. P. 8018.1.

[86] *See In re* Purdue Pharma, L.P., 635 B.R. 26, 118 (S.D.N.Y. 2021).

[87] *See* 28 U.S.C. § 158(a)(3); *Oversight of the Bankr. Code, Part 1: Confronting the Abuses of the Ch. 11 Sys.: Hearing Before the Subcomm. on Antitrust, Comm., and Admin. L. of the Subcomm. on the Judiciary*, 117th Cong. 138 (2022) (statement of Adam J. Levitin, Professor of Law, Georgetown University Law Center).

[88] Press Release, Elizabeth Warren, Warren, Nadler, Durbin, Blumenthal, Maloney Announce Legislation to Eliminate Non-Debtor Releases, Prevent Corporations and Private Entities from Escaping Accountability in Bankruptcy Proceedings (July 28, 2021), https://www.warren.senate.gov/newsroom/press-releases/warren-nadler-durbin-blumenthal-maloney-announce-legislation-to-eliminate-non-debtor-releases-prevent-corporations-and-private-entities-from-escaping-accountability-in-bankruptcy-proceedings [https://perma.cc/83DY-2LSB].

[89] Megan O'Connor, *Are Nonconsensual Third-Party Releasees Acceptable in United States Courts*, 14 ST. JOHN'S BANKR. RSCH. LIBR. No. 26 8-9 (2022).

controversies in the bankruptcy courts' application of third-party release, what it should eliminate is the circuit split on the reading of the bankruptcy code concerning non-consensual third-party release. Instead, Congress has remained silent on further defining what constitutes a "core proceeding," thus leaving the judicial branch to decide.[90]

The problem is rooted in the Bankruptcy Amendment and Federal Judgement Act of 1984, which says a case is referrable to bankruptcy courts if it is a "core proceedings" arising under Title 11.[91] The meaning of core proceedings may seem straightforward, as referring to those involving issues arising directly from the debtor's petition for bankruptcy. However, instead of giving exact definition of "core proceedings," Congress provided a non-exclusive list of sixteen types of core proceedings in 28 U.S.C. § 157 (b)(2).[92] The list indicates that core proceeding includes, among others, "matters concerning the administration of the estate," "determinations as to the dischargeability of particular debts," and "counterclaims by the estate against persons filing claims against the estate," which later led to the decision in *Stern v. Marshall* that this Note will later discuss.[93] Based on the exemplary list under 28 U.S.C. § 157(b)(2), each district developed their own criteria and tests to define and determine the scope of core proceedings.[94] Or, more precisely, bankruptcy courts have continued pushing the outer limits of their jurisdiction in their respective districts. Under Title 28, the bankruptcy judge shall determine whether a proceeding before him is a core proceeding under Title 11.[95] The determinations are subject to district court's review and confirmation.[96] Not surprisingly, as time went by, the circuit split on the interpretation of "core proceedings" widened, resulting in the different authorities among forums.[97]

The polarizing view on the legitimacy of non-consensual third-party release is closely associated with this bigger picture of

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[90] 28 U.S.C. § 157(b)(3).
[91] 28 U.S.C. § 157(a).
[92] 28 U.S.C. § 157(b)(1)-(2).
[93] 28 U.S.C. § 157(b)(2).
[94] Exec. Benefits Ins. Agency v. Arikson, 573 U.S. 25, 34 (2014).
[95] 28 U.S.C. § 157(b)(3).
[96] 28 U.S.C. § 157(b)(1).
[97] As a result, forum shopping in United States bankruptcy law become very prominent as compared to almost any other legal field. The District of Delaware and the SDNY became the forum of choice for bankruptcy matters. The two forums hear roughly 60% of Chapter 11 cases across the nation each year. Samir D. Parikh, *Modern Forum Shopping in Bankruptcy*, 46 CONN. L. REV. 159, 181 (2013).

the circuit split in the scope of bankruptcy court jurisdiction. For forums adopting more lenient standards in referring jurisdiction to bankruptcy courts, proceedings might be deemed "core" if the bankruptcy court can find a resemblance of the circumstances of the cases with one or more of the sixteen core proceedings listed under 28 U.S.C. § 157(b)(2).[98] Applying to non-consensual third-party release provisions, the Third Circuit would permit non-consensual third-party release that is "integral to the restructuring of the debtor-creditor relationship," which makes it a core proceeding of "matters concerning the administration of the estate" in 28 U.S.C. § 157(b)(2)(A). Similarly, the Second Circuit has also held a cautiously permissive attitude toward non-consensual third-party releases.[99] Non-debtor releases are permissible in the Second Circuit only where "truly unusual circumstances render the release terms important to success of the plan."[100]

However, there are still differences among those circuits that may approve non-asbestos-related reorganization plans that encompass third-party release provisions. Some circuits are more liberal to approve non-consensual third-party releases, while others undertake rigorous examination on the legitimacy and necessity of those provisions before giving green lights to a reorganization plan.[101] But the fact is: the circuit splits have continued to converge. In fact, in circuits allowing third-party release, bankruptcy courts had already developed very similar standards.[102] In *In re Mahoney Hawkes, LLP*, the Massachusetts Bankruptcy Court developed a multi-factor test that includes determinations on whether the liability release is "essential to [debtor's] reorganization" and to identify whether "an identity of interests between the debtor and the third-party, usually an indemnity relationship, such that a suit against the

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[98] 28 U.S.C. § 157(b)(2)(A)-(P).

[99] *See In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 41 (2d Cir. 2005) (holding that the court may enjoin creditor from suing a third-party, provided the injunction plays an important part in debtor's plan of reorganization, but that such release is proper only in rare cases).

[100] *See In re* Charter Commc'ns, 419 B.R. 221, 258 (Bankr. S.D.N.Y. 2009) (citing *In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 142-43 (2d Cir. 2005) ("In bankruptcy cases, a court may enjoin a creditor from suing a third-party, provided the injunction plays an important part in the debtor's reorganization plan.")).

[101] *Compare In re* Millennium Lab Holdings II, LLC, 945 F.3d 126 (3d Cir. 2019) (holding that the court will not broadly sanction the permissibility of nonconsensual third-party release in bankruptcy reorganization plans) *with In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 41 (2d Cir. 2005) (holding that nonconsensual third-party release is proper only in rare cases).

[102] *See In re* Mahoney Hawkes, LLP, 289 B.R. 285, 297-98 (Bankr. D. Mass. 2002).

non-debtor is, in essence, a suit against [t]he debtor or will deplete the assets of the estate." [103] The Seventh Circuit, affirmed a bankruptcy court's decision that a third-party release is appropriate when "necessary for the reorganization and appropriately tailored."[104] That the release is not a "blanket immunity," "applies only to claims 'arising out of or in connection with' the reorganization itself and does not include 'willful misconduct,'" and should not "affect matters beyond the jurisdiction of the bankruptcy court or unrelated to the reorganization itself."[105] The Third Circuit, known for its relative leniency in allowing third-party release, rejected the release provisions in *In re Continental*, because "[t]he hallmarks of permissible non-consensual releases—fairness, necessity to the reorganization, and specific factual findings to support these conclusions—are all absent here."[106] Additionally, all cases more or less upheld requirements to ensure non-debtor third-party's substantial contribution to the debtor's estate, the impacted parties' (creditors, claimants, etc.) overwhelming vote (but not all) to accept the plan, and mechanisms of the kind to strike a balance between giving debtors a chance for rebirth and preserving creditors' legitimate rights to recover from bankrupted estates.[107]

In recent years, the circuit split on the permissibility of third-party release provisions further narrowed. For instance, in *National Heritage Foundation v. Highbourne Foundation*, the Fourth Circuit examined the bankruptcy court's findings in the necessity of release provisions with the Sixth Circuit's "six substantive factors" enumerated in *In re Dow Corning Corporation,* reflecting a convergence of standards.[108] The factors include:

> (1) There is an identity of interests between the debtor and the third-party ...; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization ...; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; [and] (6) The plan provides an

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[103] *Id.*
[104] *See In re* Airadigm Commc'ns, Inc. v. FCC, 519 F.3d 640, 657 (7th Cir. 2008).
[105] *Id.*
[106] *In re* Continental Airlines, 203 F.3d 203, 214 (3d Cir. 2000).
[107] *See In re* Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994).
[108] Nat'l Heritage Found. v. Highbourne Found., 760 F.3d 344, 347 (4th Cir. 2014) (citing *In re* Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002)).

> opportunity for those claimants who choose not to settle to recover in full.[109]

The first factor addressed the notion of "directly affect[ing] the *res* of the bankruptcy estate," while the third factor echoed the determinative "necessarily resolved" standard in the Supreme Court's *Stern* ruling, which is the case that guides the convergence of the circuit split that this Note will discuss further. The second and fourth to sixth factors then sought to sustain the equitability of the release. The development of the various multi-factor tests has shown that determining the appropriateness of a release is "fact intensive and depends on the nature of the reorganization" and "depend[s] upon the circumstances of the case."[110] In fact, the case-by-case determination is an essential feature of bankruptcy law regime by its nature to balance case-specific interests, since "bankruptcy and insolvency laws inherently embody a compromise of disparate social and economic objectives" and "economic transactions necessarily generate competing as well as complementary interests."[111]

iii. Bankruptcy courts need the flexibility and tools in adjudicating Chapter 11 reorganizations to fulfill the purpose of their establishment

That is perhaps the real reason why Congress has restrained itself from further defining what entails bankruptcy core proceedings. The bankruptcy courts are tasked with weighing interests to achieve the greatest social equilibrium, and non-debtor release provisions have thus become an crucial and effective tool in striking a balance among parties demanding the debtor's estate.[112] When the continuance of a struggling business is in the best interest of the society as a whole, there is no reason to obstruct the

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[109] *Id.* The original list from *In re Dow Corning Corp* has seven factors. *See In re Dow Corning Corp.*, 280 F.3d at 658. The opinion in *National Heritage Foundation* did not quote the seventh factor, which is "court made a record of specific factual findings that support its conclusions." *Id.* This is because the Fourth Circuit had previously vacated the district court's finding affirming the release provision on the ground that the lower bankruptcy court failed to make sufficient factual findings to support its conclusion that the Release Provision was essential in the previous appeal. Thus, the requirement for factual findings had been remediated before this appeal. *See Nat'l Heritage Found.*, 760 F.3d at 346-47.

[110] *See In re* Airadigm Commc'ns, Inc., 519 F.3d 640, 657 (7th Cir. 2008); *see also In re* Mahoney Hawkes, LLP, 289 B.R. 285, 300 (Bankr. D. Mass. 2002).

[111] *See* Marcia S. Krieger, *"The Bankruptcy Court Is a Court of Equity": What Does That Mean?*, 50 S.C. L. REV. 275, 292-93 (1999).

[112] *See In re* Purdue Pharma L.P., 635 B.R. 26, 37 (S.D.N.Y. 2021).

bankruptcy courts' facilitation of a well-balanced plan that "relieve the honest debtor from the weight of oppressive indebtedness" to provide "a clear field for future effort" while at the same time managing to maximize recovery for the creditors and claimant.[113]

Therefore, if Congress chose to put the NRPA into effect, it is not just ripping off bankruptcy courts' authority to leverage one of the most effective tools in bankruptcy reorganization, but also runs counter to the fundamental purposes of the creation of bankruptcy court: to exert its case-specific discretion to produce socially beneficial outcomes from unfortunate business failures.[114] That is the reason why the purpose of the Bankruptcy Act has been portrayed as being both "of public as well as private interest," and that "[t]he various provisions of the Bankruptcy Act were adopted in the light of that view and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act."[115] Therefore, instead of eliminating non-consensual third-party release outright, it may be much better for Congress to build upon the many precedents among circuits to decide on an appropriate balancing rule. This will effectively limit the discretion of bankruptcy courts and the judicial review of bankruptcy courts' decisions so that bankruptcy courts and the reviewing courts, whichever stance they have now toward the non-consensual third-party release, can have clearer and uniform guidance in expanding the use of such releases to non-asbestos bankruptcies.

B. Congress should issue a uniform balancing test on the application of non-consensual third-party releases in Chapter 11 cases guided by *Stern*, which will provide a constitutional ground for a consistent and predictable application of the releases.

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[113] Loc. Loan v. Hunt, 292 U.S. 234, 244 (1934) (citation omitted) (quoting Williams v. United States Fidelity & Guar. Co., 236 U.S. 549, 554-55 (1915)); *see* Krieger, *supra* note 111, at 301-02.

[114] *See* Grogan v. Garner, 498 U.S. 279, 286 (1991) (acknowledging that the central purpose of the Bankruptcy Code is to "provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.'") (quoting *Loc. Loan*, 292 U.S. at 244).

[115] *See Loc. Loan*, 292 U.S. at 244-45 (recognizing public interest in the Bankruptcy Act to relieve an honest debtor from indebtedness and permit him to start afresh, free from obligations and responsibilities consequent upon business misfortunes).

i. <u>Congress should still step in and resolve the statutory ambiguity to streamline bankruptcy courts' standard in adjudicating non-consensual third-party releases.</u>

Despite the narrowing circuit split among those permitting non-consensual third-party releases in non-asbestos cases, Congress should still step in to resolve the statutory ambiguity. As mentioned before, the SDNY rejected the bankruptcy court's order in *Purdue* on appeal.[116] However, the decision cast even more debate and doubt. The SDNY in its comprehensive opinion not only rejected the bankruptcy court's judgment on the necessity to injunct third parties but ultimately ruled that the bankruptcy court did not have the statutory authority "to release particularized claims asserted by third parties against non-debtors."[117] This conclusion runs counter to the Southern District of New York Bankruptcy Court's past decision that "Non-debtor releases are permissible in the Second Circuit where 'truly unusual circumstances render the release terms important to success of the plan.'"[118] It also challenged the Second Circuit's cautiously permissive attitude toward non-consensual third-party releases.[119] The decision underlined the fact that the bankruptcy code only allowed third-party release in asbestos cases conferred explicitly in § 524(g), and congressional silence should not be construed to mean consent to an expansive application to non-asbestos debtors.[120] The court also made exhaustive inquiries into other parts of the bankruptcy code, and concluded that no other sections conferred a substantive right to allow non-consensual third-party releases.[121]

Even though the decision is now on appeal before the Second Circuit, it nevertheless represented the constant debate on the application of non-consensual third-party release. Without Congress's active intervention to codify the use of non-consensual third-party release in non-asbestos cases, there will still be courts that are hesitant to confirm the releases due to the statutory ambiguity, which in turn hampers the ruling flexibility that

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[116] *See In re* Purdue Pharma, L.P., 635 B.R. 26, 118 (S.D.N.Y. 2021).
[117] *Id.* at 89-90.
[118] *See In re* Charter Commc'ns, 419 B.R. 221, 258 (Bankr. S.D.N.Y. 2009) (quoting *In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 142-43 (2d Cir. 2005)) ("In bankruptcy cases, a court may enjoin a creditor from suing a third-party, provided the injunction plays an important part in the debtor's reorganization plan.").
[119] *See In re Metromedia Fiber Network, Inc*., 416 F.3d at 41 (holding that a court may enjoin a creditor from suing third-party provided the injunction plays an important part in debtor's reorganization, but that such release is proper only in rare circumstances).
[120] *See In re* Purdue Pharma, L.P., 635 B.R. 26, 109-12 (S.D.N.Y. 2021).
[121] *Id.* at 115.

bankruptcy courts should possess. The question then becomes: is there any standard that Congress can adhere to in promulgating a unified rule? This Note suggests that Congress should refer to the Supreme Court's decision in *Stern v. Marshall.*

ii. Fundamentally, Congress should follow the Supreme Court's guidance on bankruptcy court jurisdiction in *Stern v. Marshall*

In *Stern v. Marshall*, creditors challenged the bankruptcy court's jurisdiction to adjudicate a bankruptcy debtor's counterclaim against creditors for tortious interference.[122] The debtor contended that the counterclaim was within bankruptcy court jurisdiction as explicitly granted by 28 U.S.C. § 157, which purports to allow bankruptcy courts to enter judgement on counterclaims arising in all cases under Title 11 and all core proceedings arising under Title 11.[123] This is the same reasoning that circuit courts have been relying on in permitting non-consensual third-party releases,[124] which has also created much doubt in those. Like in *Purdue*, although it is not a circuit court, the SDNY refuses to apply releases in non-asbestos cases.[125]

Chief Justice Roberts, writing for the majority, agreed on the existence of the bankruptcy court's statutory authority to adjudicate the debtor's counterclaims, but rejected the debtor's argument on constitutional grounds. In the majority's opinion, the Court stated that the bankruptcy courts lack the constitutional authority under Article III of the U.S. Constitution to enter judgment of the counterclaim that did not arise from the bankruptcy itself.[126] Section 1 of Article III provides that "[t]he judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish."[127] It further provides that Article III judges "shall hold

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[122] Stern v. Marshall, 564 U.S. 462, 471 (2011).
[123] *Id.*; *see* 28 U.S.C. § 157(b)(2)(C).
[124] *See, e.g., In re* Seaside Eng'g & Surveying, Inc., 780 F.3d 1070, 1078 (11th Cir. 2015), *cert. denied*, 577 U.S. 823 (2015) (permitting third-party releases in some form, though courts generally agree that such releases should be used only in exceptional circumstances); *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 139 (3d Cir. 2019).
[125] *See, e.g., In re* Lowenschuss, 67 F.3d 1394, 1401 n.6 (9th Cir. 1995) (holding that third-party releases do not apply in non-asbestos cases because 11 U.S.C. § 524(e) states that the "discharge of a debt of the debtor does not affect the liability of any other entity on . . . such debt"); *see also In re* Pac. Lumber Co., 584 F.3d 229, 252 (5th Cir. 2009).
[126] *Stern,* 564 U.S. at 482.
[127] U.S. CONST. art. III, § 1.

their Offices during good Behaviour" and "receive for their Services, a Compensation, which shall not be diminished during their Continuance in Office."[128] Bankruptcy court judges, who enjoy neither life tenure nor salary guarantees, are not judges of the courts formed under Article III who are ensured of the independence from the Executive and Legislative branches.[129] Rather, bankruptcy courts are "legislative courts" inferior to the Supreme Court, created by Congress pursuant to their Article I powers.[130]

The opinion in *Stern v. Marshall* started by examining 28 U.S.C. § 157.[131] Under 28 U.S.C. § 157, the bankruptcy courts can enter a final judgment on claims that are part of "core proceedings".[132] Core proceedings, pursuant to U.S.C. § 157(a), refer to cases arising directly under Title 11 itself or arising in a Title 11 case. The Court dismissed the defendant's reading of U.S.C. § 157(a) — that the bankruptcy court only has jurisdiction in proceedings that are that are both core and either arise in a Title 11 case or arise under Title 11 itself — because that reading wrongly assumes that there are types of core proceedings that do not arise in a Title 11 case or under Title 11.[133] The Court also interpreted the sixteen types of core proceedings listed under 28 U.S.C. § 157(b)(2)(C) to be non-exclusive; Congress only meant to provide, "courts with ready examples of such matters."[134] In this case, the tortious interference counterclaim against the defendant is based on the defendant filing a proof of claim in the bankruptcy court asserting his right to recover damages from the bankruptcy estate.[135] Therefore, by the terms of 28 U.S.C. § 157(b)(1), the counterclaim arose in a Title 11 case (defendant's filing of a proof of claim) and thus should be deemed as a core proceeding subject to bankruptcy court jurisdiction.[136] The existence of bankruptcy court

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[128] *Id.*
[129] *See Stern*, 564 U.S. at 469; 28 U.S.C. § 152(a)(1) ("Each bankruptcy judge shall be appointed for a term of fourteen years"); 28 U.S.C. § 153 (setting forth rules determining a bankruptcy judge's salary).
[130] *See* U.S. CONST. art. I, § 8, cl. 4.
[131] *Stern*, 564 U.S. at 473.
[132] *Id.* at 473-74; 28 U.S.C. § 157(b)(1).
[133] *See Stern*, 564 U.S. at 475-76.
[134] *See id.* at 474, 476.
[135] *See id.* at 462. A Proof of Claim is an official bankruptcy form (Official Form 410) used by the creditor to indicate the amount of the debt owed by the debtor on the date of the bankruptcy filing. The creditor must file the form with the clerk of the same bankruptcy court in which the bankruptcy case was filed. *Official Form 410: Instructions for Proof of Claim*, U.S. BANKR. CT. (2022), https://www.uscourts.gov/sites/default/files/b_410instr_1215.pdf [https://perma.cc/2FXE-S4VY].
[136] 28 U.S.C. § 157(b)(1).

jurisdiction is further supported by the fact that "counterclaims by the estate against persons filing claims against the estate," is explicitly listed as one of the sixteen exemplary types of core proceedings.[137]

At this point, the Court expressly acknowledged that the subject matter is one of the designated "core proceedings" subject to bankruptcy court jurisdiction.[138] It almost seemed as if the bankruptcy court's jurisdiction was about to be pinned at the broader end of the split among circuits. However, there came a twist. First, the Supreme Court recognized that even when the bankruptcy courts acted within the "core proceedings" denominated in the plain text of 28 U.S.C. § 157, they could still encroach upon the jurisdiction of Article III courts.[139] Often bankruptcy court judges need to rule on state law issues before they can enter judgment on the bankruptcy estate.[140] Here in *Stern*, the bankruptcy court attempted to conclusively resolve a compulsory counterclaim against a proof of claim in the subject bankruptcy case, which alleged the proof of claim is tortious interference with the bankruptcy debtor's other ongoing state law proceedings outside of bankruptcy court.[141] The Court ruled that the assignment of state law to claims not otherwise part of the bankruptcy proceedings violates Article III of the Constitution, and further indicated that 28 U.S.C. § 157(b)(2), which narrowly categorize certain state law claims as Bankruptcy Court "core" proceedings, shall not end the constitutional inquiry even though the claims may seem to be closely related to the underlying Title 11 cases.[142]

iii. ***Stern's* "necessarily resolved" rule can serve as an ultimate guidance of delimiting the scope of bankruptcy courts' authority in deciding on non-consensual third-party releases.**

What type of claims, then, can bankruptcy courts adjudicate? Since the enactment of the Bankruptcy Amendments and Federal Judgeship Act of 1984, the dichotomy of core and non-core proceedings had served as bankruptcy courts' ultimate justification in finding its authority to hear and enter final judgment conclusively

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[137] 28 U.S.C. § 157(b)(2)(C).
[138] *See Stern*, 564 U.S. at 463.
[139] *See id.* at 465.
[140] U.S.C. § 157(b)(3).
[141] *See Stern*, 564 U.S. at 495.
[142] *See id.* at 462-68.

for Title 11 debtors and creditors.[143] Even today, bankruptcy courts continue to establish their jurisdiction by building on arguments that delineate the contour of 28 U.S.C. § 157(b)(1) core proceedings.[144] If the Supreme Court were to end its opinion on reaffirming bankruptcy courts' status as mere legislative courts, it would only function as striking down the Bankruptcy Amendments and Federal Judgeship Act of 1984. [145] This might destroy the practical functionality of bankruptcy courts, and propel Congress to step in to reform the bankruptcy procedures and give a much clearer outline of bankruptcy court jurisdiction. However, the Supreme Court's decision in *Stern* disincentivizes Congress of such actions and continues to influence the landscape of bankruptcy procedures and jurisdiction today. The third-party release measures are no exception.

Even though the decision in *Stern* significantly curtailed bankruptcy courts' jurisdiction, the Court handed down a "necessarily resolved" rule that nevertheless left bankruptcy courts with enough leeway to fulfill the primary mission entrusted to them by the nation's bankruptcy statutory establishment: to provide a centralized forum to resolve all inextricable matters surrounding private insolvency. [146] The Court in *Stern* did not hold that all counterclaims were beyond the scope of bankruptcy courts' hands, but only those that do not have sufficient connection with an underlying Title 11 case, and that will not be necessarily resolved in bankruptcy courts' judgment on the debtor-creditor relationship.[147] In other words, bankruptcy courts can still resolve Title 11 cases and perform their core functions, such as creditor collection, debtor reorganization, and asset liquidation, if the claims are so closely related to the extent that they can be necessarily resolved in the bankruptcy court's final judgment in claim allowance. The Court found a way to preserve the legislative purpose served by the grant of adjudicatory authority to bankruptcy tribunals.[148] Perhaps it was because both the majority and the dissent in *Stern* can agree that the, "power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question."[149]

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[143] *See* 28 U.S.C. § 157(b)(1).
[144] *See Stern*, 564 U.S. at 474-75.
[145] *See* N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 86 (1982).
[146] *See Stern*, 564 U.S at 502-03.
[147] *See id.* at 502.
[148] *See id.* at 517 (Breyer, J., dissenting).
[149] *See id.* at 518 (Breyer, J., dissenting) (quoting THE FEDERALIST NO. 42, at 271 (James Madison) (Clinton Rossiter ed., 1961)).

iv. Many circuits have already incorporated *Stern's* "necessarily resolved" rule when deciding on non-consensual third-party release provisions. Congress can build on the precedents to issue a uniform balancing test.

This Note suggests that Congress should build upon the *Stern* holding to develop a uniform balancing test in applying non-consensual third-party releases in non-asbestos cases. In fact, the "necessarily resolved" rule in *Stern* has been particularly leveraged in non-consensual third-party released cases since its inception.[150] In December 2019, the Third Circuit upheld the bankruptcy court's confirmation on *Millennium Lab Holdings II* and its affiliates' (hereafter "Millennium") bankruptcy reorganization plan that contained non-consensual third-party releases.[151] Millennium became insolvent after failing to fulfill its settlement with the Department of Justice and the Center for Medicare and Medicaid Services on allegations of health care fraud.[152] In 2016, the United States Bankruptcy Court for the District of Delaware confirmed Millennium's reorganization plan which provided that its existing equity holders will infuse $325 million and hand over 100% of the beneficial ownership of the reorganized Millennium to the creditors and claimants in exchange for releasing debtors from all existing and future claims.[153] One of the creditors, Voya Investment Management Co. LLC and its affiliates (hereafter "Voya"), objected to the confirmation of the plan because, "it intended to assert significant legal claims" against Millennium for a material misrepresentation concerning a 2014 credit agreement between the two parties.[154] Voya thus appealed the bankruptcy court's confirmation of the plan to the Third Circuit Court of Appeals.[155]

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[150] Jacob S. Mezei, *Second Circuit Picks a Side in Non-Consensual Third-Party Releases in Highly Anticipated Purdue Opinion*, SHEARMAN & STERLING (June 9, 2023), https://www.shearman.com/en/perspectives/2023/06/second-circuit-picks-side-in-non-consensual-3rd-party-releases-in-purdue-opinion [perma.cc/B6LQ-QFQZ].

[151] *See In re* Millennium Lab Holdings II, LLC, 945 F.3d 126, 144 (3d Cir. 2019).

[152] *Millennium Laboratories to Pay $256 Million to Resolve False Billing and Kickback Claims*, DEP'T OF JUST. (Oct. 19, 2015), https://www.justice.gov/usao-ma/pr/millennium-laboratories-pay-256-million-resolve-false-billing-and-kickback-claims [https://perma.cc/NZ9E-APB9].

[153] *In re* Millennium Lab Holdings II, LLC, 543 B.R. 703, 705-06, 717 (Bankr. D. Del. 2016).

[154] *In re Millennium Lab Holdings II, LLC*, 945 F.3d at 132.

[155] *Id.* at 126.

Since Voya's argument mainly relied upon the holding in *Stern*, the Third Circuit's opinion in *Millennium* had thus become an important interpretation and application of *Stern*'s "necessarily resolved" rule on non-consensual third-party release.[156] Voya argued that its intended claims of misrepresentation neither stem from Millennium's bankruptcy and reorganization, nor would be resolved in the claims allowance process.[157] In response, the Third Circuit held that the correct interpretation of *Stern* is that the bankruptcy court is within constitutional bounds when it resolves a matter that is integral to the restructuring of the debtor-creditor relationship.[158] This is the test of whether a claim against bankruptcy estate would necessarily be resolved in the claims allowance process.[159] Applying the foregoing principle to the facts of *Millennium*, the non-consensual third-party release provisions were integral to the success of Millennium's reorganization.[160] This is because without the liability releases and injunction provisions in the reorganization plan, Millennium "[would not be] willing to make their contributions under the Plan and, absent those contributions, [Millennium would] be unable to satisfy their obligations under the USA Settlement Agreements . . . and no chapter 11 plan [would] be feasible."[161] Consequently, Millennium would likely be left with only one option: cease operation upon the authority's enforcement against Millennium. The Third Circuit further rejected Voya's contention that *Stern* limited bankruptcy court's jurisdiction to matters involving the claims allowance process.[162] Conversely, the Third Circuit explained that matters involving the claims allowance process fall under bankruptcy courts' jurisdiction because they are undoubtedly, "integral to the restructuring of debtor-creditor relations."[163]

The "integral to the restructuring" rule laid a constitutional foundation for bankruptcy courts' confirmation of plans encompassing non-consensual third-party releases for Plans of Reorganization.[164] Chapter 11 reorganizations, at its most basic, are for entities seeking a bankruptcy court-ordered agreement on their

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[156] *In re Millennium Lab Holdings II, LLC*, 575 B.R. at 275.
[157] *Id.* at 274.
[158] *See id.* at 261.
[159] *See In re Millennium Lab Holdings II, LLC*, 945 F.3d at 135 (citing Stern v. Marshall, 564 U.S. 462, 499 (2011)).
[160] *In re Millennium Lab Holdings II, LLC*, 945 F.3d at 137.
[161] *Id.*
[162] *See id.* at 138-39.
[163] *See id.* at 138.
[164] *See, e.g.*, *In re* Mallinckrodt PLC, 639 B.R. 837, 866 (Bankr. D. Del. 2022); *In re* S B Bldg. Assocs., 621 B.R. 330, 372 (Bankr. D.N.J. 2020).

proposed exit strategy to resolve creditor claims over time and keep their business alive.[165] This process is based on the assumption that every bankruptcy debtor has claims pending against it that it can no longer bear.[166] Certainly, bankruptcy courts' authority to confirm reorganization plans that encompass non-consensual third-party releases are not unlimited. Bankrupted debtors have every incentive to make the releases, "as broad as possible in their scope," and include as many contributors, who may only have a causal connection to the bankrupt estate, into the plan as possible.[167] That is perhaps why the Supreme Court in *Stern* carved out Congress's unconstitutional grant of Article III authority to bankruptcy courts, yet at the same time put up the "necessarily resolved" rule to reaffirm and guide bankruptcy court jurisdiction and judgment on core proceedings. Merely making a "material contribution" to the plan to conclusively resolve claims is not enough for the bankruptcy court to approve a non-consensual third-party release.[168] Non-consensual third-parties releases are only permissible if "there are circumstances under which [the court] might validate a non-consensual release that is both necessary and given in exchange for fair consideration."[169]

Applying the aforementioned standards, a release provision should not be granted "unless barring a particular claim is important in order to accomplish a particular feature of the restructuring."[170] That is, there have to be, "truly unusual circumstances to render the release terms important to success of the plan," that but for the third-party release, no other restructuring tools available can achieve the same result of keeping the bankrupted debtor alive.[171] Afterall, if bankruptcy courts cannot exert jurisdiction to resolve claims that,

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[165] *See Chapter 11 - Bankruptcy Basics*, *supra* note 1; Michael J. Riela, *The Current State of Non-Consensual Third-Party Releases in Chapter 11 Bankruptcy Cases*, N.Y. L.J. (June 24, 2022, 10:00 AM), https://www.law.com/newyorklawjournal/2022/06/24/non-consensual-third-party-releases-in-chapter-11-cases/.

[166] *Chapter 11 Bankruptcy*, BLOOMBERG L. (Mar. 8, 2022), https://pro.bloomberglaw.com/brief/chapter-11-bankruptcy/ [https://perma.cc/AU92-QTUE].

[167] *In re* Aegean Marine Petroleum Network Inc., 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019).

[168] *See In re* Metromedia Fiber Network, Inc., 416 F.3d 136, 143 (2d Cir. 2005).

[169] *See In re* Genesis Health Ventures, Inc., 266 B.R. 591, 603 (Bankr. D. Del. 2001) (quoting *In re* Continental Airlines, 203 F.3d 203, 211 (3d Cir. 2000)).

[170] *See In re* Aegean Marine Petroleum Network Inc., 599 B.R. 717, 727 (Bankr. S.D.N.Y. 2019).

[171] *See In re* Charter Commc'ns, 419 B.R. 221, 258 (Bankr. S.D.N.Y. 2009) (quoting *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 142-43).

"directly affect the *res* of the bankruptcy estate"[172] and ensure the success of reorganization plans, how can bankruptcy courts ever fulfill federal bankruptcy law's fundamental goal to "giv[e] the honest but unfortunate debtor . . . a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt[?]"[173]

The Supreme Court later denied Voya's petition for writ of certiorari, suggesting the Court's acknowledgment and acceptance of the Third Circuit's reasoning on the constitutionality of non-consensual third-party release provisions, at least under the particular circumstances in *Millennium*.[174] Fundamentally, what the Court focuses on is preserving the constitutional scheme of a tripartite government, so that the judicial power of the United States will not be encroached upon by the legislative branch and individual rights will be secured by the separation of powers.[175] It is perhaps one of the reasons why the Court has been cautious not to intrude upon the legislative branch's authority in regulating bankruptcy reorganizations, which in this nation's bankruptcy law traditions, has been inextricably propelled by the principle to offer liability discharge that incentive debtors need to embrace a fresh start.[176] However, the means to achieve a balance between offering the debtor a discharge and fulfilling the creditor's right to recollection must be carefully scrutinized. Federal courts' review of bankruptcy courts' decisions are thus crucial, particularly since non-consensual third-party releases are regarded as the last resort among the various reorganization mechanism. In order for judicial review to be reliable and predictable, the remaining circuit split in applying non-

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[172] *In re* Johns-Manville Corp., 517 F.3d 52 (2d Cir. 2008).
[173] *See Process - Bankruptcy Basics*, U.S. COURTS, https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics [https://perma.cc/4BBL-FQNE] (last visited Jan. 20, 2024) (quoting Loc. Loan v. Hunt, 292 U.S. 234, 244 (1934)); *see also* Krieger, *supra* note 111, at 292 (recognizing that although it is in the interest of every creditor to be paid, when full recovery unattainable, it is "in society's interest that all creditors be treated predictably and that debtors be returned to productivity").
[174] *See In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019), *cert. denied,* 140 S. Ct. (2020).
[175] *See* U.S. CONST., art. III, § 1; *see also* Stern v. Marshall, 564 U.S. 462, 483-84 (2011).
[176] *See* Richard S. Davis, *Protection of a Debtor's "Fresh-Start" Under the New Bankruptcy Code*, 29 CATH. U.L. REV. 843, 846-50 (1980) (discussing the development of the fresh start doctrine in U.S. bankruptcy law since the enactment of the Bankruptcy Reform Act of 1978 that has shifted the focus on maximal return for creditors to a balance of creditors' and debtors' interests); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. J.L. & TECH. 1393, 1395-98 (1985) (explaining that discharge policy can incentivize a debtor to avail himself of the bankruptcy laws and proceedings for a chance to obtain a fresh start).

consensual third-party release should be resolved by Congress. Building upon the many precedents among circuits, Congress may decide on an appropriate balancing test to limit the discretion of bankruptcy courts that supplement to *Stern*'s "necessarily resolved" rule, so that bankruptcy courts and their reviewing courts can have a clearer guidance in expanding the use of non-consensual third-party releases to non-asbestos bankruptcies.

III. CONCLUSION

While the scope of application in non-consensual third-party release merits further settlement, a blanket prohibition imposed by NRPA is far from ideal. Since *Stern*, bankruptcy courts have leveraged non-consensual third-party release cautiously within its limited constitutional authority. Reviewing courts, regardless of having either permissive or reserved attitudes toward the release mechanism, have also worked toward creating a more uniform rule in balancing creditors' rights of claim and debtors' opportunity to obtain a successful reorganization and revival. NRPA's enactment would abruptly end this development. Moreover, it imposes a highly restrictive regime on bankruptcy courts that is far more limited than the constitutional authority the Supreme Court has carefully delineated in *Stern*. This affects not only non-consensual third-party releases but also the interpretation of bankruptcy courts' overall jurisdiction under Chapter 11 in confirming plans of reorganization. In conclusion, rather than hastily imposing a blanket prohibition through NRPA that severely curtailed bankruptcy court authority, Congress should play a much more active role in resolving the debate. Congress should build upon the *Stern* decision and further delineate the application of such releases in ways that align with the fundamental goals of Chapter 11 reorganizations.