

ABI Rocky Mountain Bankruptcy Conference

Section 363 Sales and Related Issues

Denver, Colorado  
January 21-22, 2009

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## Section 363 Sales Free and Clear v. Sub Rosa Chapter 11 Plans

### A. **Indiana State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC), \_\_\_ F.3d \_\_\_ (2d Cir., August 5, 2009)**

#### i. Facts

Chrysler commenced its chapter 11 case on April 30, 2009 with a proposal to sell, pursuant to Bankruptcy Code section 363, substantially all its operating assets (including manufacturing plants, brand names, certain dealer and supplier relationships, etc.) to New Chrysler in exchange for New Chrysler's assumption of certain liabilities and \$2 billion cash. Slip op. at 7-8. The bankruptcy court approved the sale by order dated June 1, 2009. Slip op. at 9.

The United States Court of Appeals for the Second Circuit affirmed on June 5, 2009, but entered a short stay pending Supreme Court review. The Supreme Court extended the stay, but declined a further extension and the sale closed on June 10, 2009. Slip op. at 9.

Under the sale, “[n]ot one penny of value of the Debtors’ assets is going to anyone other than the First Lien Lenders.” Slip op. at 25. “[A]ll the equity stakes in New Chrysler were entirely attributable to new value – including governmental loans, new technology, and new management – which were not assets of the debtor’s estate.” Slip op. at 25. “The linchpin of [the bankruptcy court’s] analysis was that the only possible alternative to the Sale was an immediate liquidation that would yield far less for the estate – and for the objectors.” Slip op. at 25-26.

New Chrysler’s membership interests were 55% to an employee benefit entity created by the United Auto Workers union, 8% to the United States Treasury, and 2% to Export Development Canada. Slip op. at 8. “Fiat, for its contributions, would immediately own 20% of the equity with rights to acquire more (up to 51%), contingent on payment in full of the debts owed to the United States Treasury and Export Development Canada.” Slip op. at 8-9. “Fiat had conditioned its commitment on the Sale being completed by June 15, 2009. While this deadline was tight and seemingly arbitrary, there was little leverage to force an extension.” Slip op. at 27. The union employees would be working under new union contracts containing a six-year no-strike provision. Slip op. at 28.

#### ii. Issues

1. Is the sale an impermissible sub rosa plan, unapprovable under Bankruptcy Code section 363?
2. Does the sale conform to Bankruptcy Code section 363(f)? Does the “Sale impermissibly [subordinate the Indiana Pensioners’] interests as secured

lenders and [allow] assets on which they have a lien to pass free of liens to other creditors and parties, in violation of § 363(f)?" Slip op. at 10.

3. Is it constitutional to use TARP funds to finance the sale?
4. Can the sale be made free and clear of present and future tort and asbestos claims?

iii. Holdings

1. No. "On this record, and in light of the arguments made by the parties, the bankruptcy court's approval of the Sale was no abuse of discretion. With its revenues sinking, its factories dark, and its massive debts growing, Chrysler fit the paradigm of the melting ice cube. Going concern value was being reduced each passing day that it produced no cars, yet was obliged to pay rents, overhead, and salaries. Consistent with an underlying purpose of the Bankruptcy Code – maximizing the value of the bankrupt estate – it was no abuse of discretion to determine that the Sale prevented further, unnecessary losses. *See Toibb v. Radloff*, 501 U.S. 157, 163 (1991) (Chapter 11 'embodies the general [Bankruptcy] Code policy of maximizing the value of the bankruptcy estate.')." Slip op. at 27-28.
2. "[T]he secured lenders have consented to the Sale, as per § 363(f)(2)." Slip op. at 10.
3. "We conclude that the Indiana Pensioners lack standing to raise this challenge" to the use of TARP funds. Slip op. at 10.
4. The sale was legally approved free and clear of tort claims. "Because appellants' claims arose from Old Chrysler's property, § 363(f) permitted the bankruptcy court to authorize the Sale free and clear of appellants' interest in the property." Slip op. at 49-50. This includes present asbestos claims. Bankruptcy Code section 524(g) only applies to a chapter 11 plan, and the sale order did not violate it. Slip op. at 51. In respect of whether the sale order legally approved the transfer of assets free of future asbestos claims: "We affirm this aspect of the bankruptcy court's decision insofar as it constituted a valid exercise of authority under the Bankruptcy Code. However, we decline to delineate the scope of the bankruptcy court's authority to extinguish future claims, until such time as we are presented with an actual claim for an injury that is caused by Old Chrysler, that occurs after the Sale, and that is cognizable under state successor liability law." Slip op. at 52.

iv. Rationale

“...Thus a § 363(b) sale may well be a reorganization in effect without being the kind of plan rejected in *Braniff*. See, e.g., *Fla. Dep’t of Revenue v. Piccadilly Cafeterias, Inc.*, 128 S. Ct. at 2330 n.2....” Slip op. at 23-24. “*Braniff* rejected a proposed transfer agreement in large part because the terms of the agreement specifically attempted to dictat[e] some of the terms of any future reorganization plan. The [subsequent] reorganization plan would have to allocate the [proceeds of the sale] according to the terms of the [transfer] agreement or forfeit a valuable asset....” Slip op. at 22 (brackets in original). “*Braniff*’s holding did not support the argument that a § 363(b) asset sale must be rejected simply because it is a sale of all or substantially all of a debtor’s assets. Thus a § 363(b) sale may well be a reorganization in effect without being the kind of plan rejected in *Braniff*.<sup>9</sup>” Slip op. at 9 & n.9 (n9: “The transaction at hand is as good an illustration as any. ‘Old Chrysler’ will simply transfer the \$2 billion in proceeds to the first lien lenders, and then liquidate. The first lien lenders themselves will suffer a deficiency of some \$4.9 billion, and everyone else will likely receive nothing from the liquidation. Thus the Sale has inevitable and enormous influence on any eventual plan of reorganization or liquidation. But it is not a ‘sub rosa plan’ in the *Braniff* sense because it does not specifically ‘dictate,’ or ‘arrange’ *ex ante*, by contract, the terms of any subsequent plan.”).

*Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1069 (2d Cir. 1983), “reject[ed] the requirement that only an emergency permits the use of § 363(b).” Slip op. at 14. “...Lionel required a ‘good business reason’ for a § 363(b) transaction.” Slip op. at 15.

“As § 363(b) sales proliferate, the competing concerns identified in *Lionel* have become harder to manage. Debtors need flexibility and speed to preserve going concern value; yet one or more classes of creditors should not be able to nullify Chapter 11’s requirements. A balance is not easy to achieve, and is not aided by rigid rules and prescriptions. *Lionel*’s multi-factor analysis remains the proper, most comprehensive framework for judging the validity of § 363(b) transactions.” Slip op. at 21.

#### v. Analysis

The term ‘*sub rosa* plan’ has taken on two meanings. The original meaning was shown in *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.)*, 700 F.2d 935 (5<sup>th</sup> Cir. 1983), to be a sale transaction that also included distributions of sale proceeds which would otherwise be distributed in a chapter 11 plan. In *Braniff*, the appellate court held the transaction was illegal because it included at least three elements outside the scope of section 363, which would otherwise be subject to the Bankruptcy Code’s confirmation requirements. They were the requirements that: (a) *Braniff* pay \$2.5 million to the buyer for travel scrip which had to be distributed to former *Braniff* employees or shareholders, (b) the secured lenders vote a portion of their deficiency claim in favor of any future plan secured approved by a majority of the creditors’ committee, and (c) all parties release *Braniff*, its secured lenders, and its officers and directors. *Braniff*, 700 F.2d at 939-940. In *Motorola, Inc. v. Official Committee of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452

(2d Cir. 2007), a settlement between the debtor and the secured lenders provided for left over funds for litigation, if any, to be distributed to unsecured claimholders, rather than be available for unpaid administrative claims. 478 F.3d at 459-460. At the time of the settlement, however, it was still unclear whether there would be unpaid, allowed administrative claims. 478 F.3d at 464. Therefore, the court declined to hold the bankruptcy court cannot approve a settlement outside a plan, which settlement may violate the Bankruptcy Code's distribution scheme. 478 F.3d at 464. Rather, the court ruled: "In the Chapter 11 context, whether a settlement's distribution plan complies with the Bankruptcy Code's priority scheme will often be the dispositive factor. However, where the remaining factors weigh heavily in favor of approving a settlement, the bankruptcy court, in its discretion, could endorse a settlement that does not comply in some minor respects with the priority rule if the parties to the settlement justify, and the reviewing court clearly articulates the reasons for approving, a settlement that deviates from the priority rule." 478 F.3d at 465.

The second meaning of *sub rosa* plan has been a transaction that does not distribute proceeds in lieu of a chapter 11 plan distribution, but disposes of a crown jewel asset that may restrict the type of chapter 11 plan that must result. See, e.g., *Richmond Leasing Co. v. Capital Bank, N.A.*, 762 F.2d 1303, 1312-1313 (5<sup>th</sup> Cir. 1985)(affirmed assumption of amended lease creating large administrative claims based on valid exercise of debtor's business judgment, while cautioning that assumption and other factors could sometimes create *sub rosa* plan) ; *Inst. Creditors of Continental Air Lines, Inc. v. Continental Air Lines, Inc. (In re Continental Air Lines, Inc.)*, 780 F.2d 1223 (5<sup>th</sup> Cir. 1986). In *Continental*, the appellate court reversed the bankruptcy court's approval of the debtor entering into leases of two large aircraft because the court had not considered whether the objecting creditors would have been able to block the leases if proposed in a chapter 11 plan. 780 F.2d at 1227-1228.

In *Chrysler*, the section 363 transaction included (a) the distribution of sale proceeds to the first lien holders, rather than simply have the liens attach to the proceeds, which distribution clearly eliminated the estate's use of the funds (subject to adequate protection requirements) for reorganization, and (b) the payment of prepetition, unsecured trade debt. The objectors to the Chrysler transaction did not raise either of these features in their objections, but they clearly rendered the transaction a partial *sub rosa* plan.

The appellate court's deferral of its review of the enforceability of the sale order's provision that the sale was free of successor liability for future claims, sets up an interesting dynamic. When and if a claimant asserts a future claim against the buyer, the buyer may attempt to enforce the sale order in the bankruptcy court which issued it by suing the claimant for contempt of the injunction in the sale order. Alternatively, the claimant may start out by requesting relief from the injunction in the bankruptcy court. The bankruptcy court will presumably have little choice but to enforce the order. The district court and Second Circuit will then determine whether the order can be collaterally attacked and, if so, whether it was valid. *Travelers Indemnity Co. v. Bailey*,

129 S. Ct. 2195 (2009), certainly creates a question as to whether the order can be collaterally attacked.

Whether a sale of a title 11 estate's assets may be free of future claims (tort victims injured in post-sale accidents in cars sold pre-sale; or individuals exposed to asbestos pre-sale who first manifest injury post-sale) depends on the mode of analysis. If analyzed as a function of procedural due process, the sale free of future claims may not pass constitutional muster unless a representative is appointed to represent them at the hearing, or other litigants with consistent interests are represented. If analyzed as a function of federal preemption, the court may determine that state law cannot constitutionally preempt federal bankruptcy law by imposing discharged claims against the buyer of estate assets sold because that would undermine the Congressional priority scheme. The litigants in the preemption litigation could be the debtor and the attorneys general for the states seeking to impose their successor liability laws.

**2. Limits and Extensions of *Official Unsecured Creditors' Committee v. Stern* (In re SPM Manufacturing Corp.), 984 F.2d 1305 (1st Cir. 1993)**

**A. *Official Unsecured Creditors' Committee v. Stern* (In re SPM Manufacturing Corp.), 984 F.2d 1305 (1st Cir. 1993)**

i. Facts

The statutory creditors' committee representing creditors owed \$5.5 million determined a reorganization under existing management was unfeasible and a liquidation would leave nothing for any creditor other than the secured claimholder. 984 F.2d at 1307-1308. The committee agreed with the creditor holding a \$9 million claim secured by all estate assets except certain encumbered real estate that the two entities would cooperate to (i) take all actions reasonably necessary to replace the debtor's chief executive officer, (ii) formulate a joint chapter 11 plan, and (iii) negotiate in good faith to reach mutually acceptable agreements with respect to a number of details of the plan. 984 F.2d at 1307n.2, 1308. The secured creditor agreed to allocate the net proceeds it obtains in reorganization or liquidation between itself and the committee according to a schedule under which the committee obtains 10% of the first \$3 million, 20% of the next \$3 million, 30% of the next \$3 million, 40% of the next \$3 million, and 100% of any further proceeds the secured creditor obtains. 984 F.2d at 1308.

The Internal Revenue Service held a \$750,000 unsecured priority tax claim for unpaid withholding taxes certain insiders would be responsible for if not paid by the debtor. 984 F.2d at 1307. The IRS is not a party to the appeal and appears not to have participated in the bankruptcy court.

The committee filed the agreement as an exhibit to a motion, and the court expressed concern and characterized the agreement as a 'tax-avoidance' scheme. 984 F.2d at 1308. At no time did any creditor or insider object to the agreement and it was never formally approved or disapproved until a chapter 7 trustee requested that the

secured claimholder turn over to the estate the funds allocable to unsecured claimholders under the agreement. *Id.*

The agreement expressly stated the committee was making the agreement on behalf of general unsecured creditors "exclusive of the Internal Revenue Service and potential 'insider' creditors." 984 F.2d at 1308.

When the case was converted to chapter 7, the chapter 7 trustee opposed a joint motion of the secured claimholder and the committee to distribute the secured claimholder's net proceeds in accordance with the agreement. The bankruptcy court ruled the proceeds allocable to the committee should go to the estate for distribution in accordance with chapter 7 priorities including the Internal Revenue Service. 984 F.2d at 1309. The bankruptcy court treated the joint motion as a motion to approve the agreement and refused to grant it. 974 F.2d at 1309n.5. The district court affirmed. 974 F.2d at 1310.

ii. Issue

Did the bankruptcy court err as a matter of law in ordering the secured claimholder to pay a portion of its secured interest to the chapter 7 estate as opposed to the unsecured claimholders under the agreement? 974 F.2d at 1310.

iii. Holding

The court of appeals reversed and vacated the bankruptcy court's award of the committee's allocation to the estate.

"...While a creditors' committee and its members must act in accordance with the provisions of the Bankruptcy Code and with proper regard for the bankruptcy court, the committee is a fiduciary for those it represents, not for the debtor or the estate generally." 974 F.2d at 1315.

"The creditors' committee is not merely a conduit through whom the debtor speaks to and negotiates with creditors generally. On the contrary, it is purposely intended to represent the necessarily different interests and concerns of the creditors it represents. It must necessarily be adversarial in a sense, though its relation with the debtor may be supportive and friendly. There is simply no other entity established by the Code to guard those interests. The committee as the sum of its members is not intended to be merely an arbiter but a partisan which will aid, assist, and monitor the debtor pursuant to its own self-interest." 974 F.2d at 1316.

"...We conclude, therefore, that the bankruptcy court erred as a matter of law insofar as it felt that the Committee was under a particular duty to negotiate the sharing provision of the Agreement for the benefit of the estate as a whole." 974 F.2d at 1316.

The appellate court noted the secured lender was willing to abide by its agreement, and that the issue of the agreement's enforceability was not before it. 974 F.2d at 1318.

Additionally, the court of appeals ruled the committee's allocable portion of the proceeds was not estate property once the automatic stay terminated and the court ordered the sale proceeds distributed to the creditor, and therefore the bankruptcy court had no jurisdiction to order its return to the estate. 974 F.2d at 1313. Therefore, the matter was remanded for the bankruptcy court to determine whether the estate or the secured lender should be responsible for distributing the committee's allocation, with the appeals court warning that appellant had not pointed to any basis in the Bankruptcy Code for authorizing, let alone requiring, the bankruptcy court or trustee to administer a distribution of nonestate funds pursuant to a private agreement. 974 F.2d at 1319.

#### iv. Rationale.

The court of appeals explained the committee is not a fiduciary for the debtor or estate as a whole. Rather, it is a fiduciary only for those whom it represents. "It is charged with pursuing whatever lawful course best serves the interests of the class of creditors represented....It must necessarily be adversarial in a sense, though its relation with the debtor may be supportive and friendly....The committee as the sum of its members is not intended to be merely an arbiter but a partisan which will aid, assist, and monitor the debtor pursuant to its own self-interest." Because the committee was only obtaining a share of whatever would be distributed to the secured lender, the court did not believe any other creditor, such as the IRS, was unfairly hurt.

In response to arguments that such agreements conflict with bankruptcy policies, the court of appeals noted the bankruptcy court's power to disqualify votes cast in bad faith and to reconstitute creditors' committees failing to be properly representative enable it to control the tenor of proceedings. The court noted the good faith requirement bars creditors from casting votes for ulterior motives, such as coercing a higher payment from the estate, pure malice, and advancing the interests of a competing business. 974 F.2d at 1317.

#### v. Implications

Prior to bankruptcy there is no law against intercreditor agreements allocating future distributions from a bankruptcy case. Indeed, subordination agreements do that everyday. The question becomes whether something changes the innocuous nature of such agreements when consummated postpetition, especially by a statutory committee.

In *SPM*, the agreement itself was somewhat defensive. It was drafted as an agreement to join in a reorganization plan, when its bottom line purpose was to evade the requirements of a plan in 11 U.S.C. § 1129(a)(9)(C) that the priority tax claim be paid in full. Thus, the agreement actually contemplated a liquidation in chapter 7.

The agreement entered into in *SPM* diminished the committee's incentive to avoid the secured lender's lien, albeit there is nothing in the decision to suggest that was possible. Moreover, it flat out committed the committee to try to replace management. If the committee entered into that commitment to obtain compensation for creditors rather than because it believed management was subpar, Bankruptcy Rule 9011 would be implicated if the committee filed motions to replace management without good grounds therefor. There is nothing to suggest it did.

Notably, the decision shows that creditors not represented by a statutory committee can not count on the committee to police the case. The creditors will have to do so themselves, usually at their own expense. Additionally, the bankruptcy court was never asked to approve the agreement until the time came to disburse the funds. Therefore, whether the committee had a good basis to join forces with the secured lender and perhaps not vigorously attack the security interests was never tested. Other creditors may not have known about the agreement.

Finally, it is not clear the committee had the capacity to enter into the agreement, to be held to it, or to bind its constituency to it. But, the committee was able to fulfill the agreement's requirements to the creditor. The agreement also provided no mechanism to resolve creditors' claims before distributions of the amount obtained from the secured claimholder. The appellate court suggested strongly that the bankruptcy court should not be used to implement a private agreement to distribute nonestate funds. Had the funds been deemed estate funds, then they would have to be paid to the IRS instead to general unsecured claimholders.

### ***B. In re Armstrong World Industries, 432 F.3d 507 (3d Cir. 2005)***

#### **i. Facts**

The debtor, Armstrong, negotiated a chapter 11 plan in its mass tort asbestos case. Pursuant to the proposed plan, general nonasbestos creditors would recover approximately 59.5% of their \$1.651 billion of claims, while the asbestos claims and demands would initially recover 20% of their claims from a fund of \$1.8 billion, and shareholders would receive warrants worth \$35 million to \$40 million. 432 F.3d at 509. The proposed plan provided that if the nonasbestos claimants rejected the plan the warrants would be distributed to the asbestos claimants; provided further, that the asbestos claimants would automatically waive receipt of the warrants which would then be issued to the shareholders. *Id.*

Although the commercial creditors' committee initially approved of the proposed plan, it later withdrew support largely because Armstrong would have to pay only up to \$805 million (instead of \$1.8 billion) for asbestos claims if Congress passed asbestos legislation. The class of commercial creditors then rejected the plan and the commercial creditors' committee objected to confirmation on the ground it violated the absolute priority rule and because commercial creditors would have a greater return if the legislation passed. 432 F.3d at 510.

The bankruptcy court recommended confirmation of the proposed plan on the ground the waiver by the class of asbestos claimants did not violate the absolute priority rule, and because the commercial creditors' committee waived its right to object to the plan when it entered into a consensual plan providing for the waiver. 432 F.3d at 510. The district court denied confirmation on the ground it violated the absolute priority rule and because no equitable exception to the absolute priority rule applied. *In re Armstrong World Indus., Inc.*, 320 B.R. 523 (D. Del. 2005).

ii. Issues

Does the absolute priority rule apply when the rejecting class is not an intervening class between the class yielding value to a junior class and the junior class?

Is the absolute priority rule violated when an accepting class of claims having dissenting members (Class 7) agrees to transfer a portion of its distribution to an equity class (Class 12) when a co-equal class of claims (Class 6) rejects the plan?

Is there a basis to create an equitable exception to the absolute priority rule when (a) the creditors' committee negotiates, endorses, and then withdraws support for the plan, (b) the transfer to the junior class does not come at the expense of the rejecting class, (c) the transfer to the junior class is of a relatively small value, (d) the rejecting class has a majority in number (though not in amount) accepting the plan, and (e) the rejecting class caused delay?

iii. Holdings

"...The plain language of the statute makes it clear that a plan cannot give property to junior claimants over the objection of a more senior class that is impaired, but does not indicate that the objecting class must be an intervening class." 432 F.3d at 513.

"...In turn, Class 7 automatically waived the warrants in favor of Class 12, without any means for dissenting members of Class 7 to protest. Allowing this particular type of transfer would encourage parties to impermissibly sidestep the carefully crafted strictures of the Bankruptcy Code, and would undermine Congress's intention to give unsecured creditors bargaining power in this context. See H.R. Rep. No. 95-595, at 416, reprinted in 1978 U.S.C.C.A.N. 5963, 6372 (' [Section 1129(b)(2)(B)(ii)] gives intermediate creditors a great deal of leverage in negotiating with senior or secured creditors who wish to have a plan that gives value to equity.')." 432 F.3d at 514-515.

"In addition, our application of equitable considerations in *Penn Central* [596 F.2d 1127, 1142 (3d Cir. 1979)] did not mean that the absolute priority rule was abandoned. Rather, we held firm to the idea that the rule still 'required...that provision be made for satisfaction of senior claims prior to satisfaction of junior claims.' *Id.* at 1153." 432 F.3d at 517.

## iv. Analysis

*Armstrong*, at its core, bars the expansion of *SPM* to enable an accepting class with dissenting members or an accepting class having less than a unanimous vote, to cause a portion of its distribution to be transferred to a junior class when a class senior to the junior class rejects and is not paid in full.

*Armstrong* also answers the question as to whether the absolute priority rule should be modified, as a matter of policy, to allow a class to transfer value to a junior class when a senior class rejects. *Armstrong* explains, using legislative history, that such a modification would deprive creditors of the negotiating leverage Congress gave them with the absolute priority rule. One can easily conjure up scenarios in which debtors or equity classes could use such a modification to condition their proposal of a chapter 11 plan on a creditors' class agreement to transfer value to equity. This possibility would, in turn, cause uncertainty in the capital markets as to how to value the creditor claims and result in inefficient asset allocation.

Most recently, in *In re DBSD North America, Inc.* Case No. 09-13061 (Bankr. S.D.N.Y., filed October 26, 2009) (REG) (Slip Op.), the court confirmed a chapter 11 plan providing distributions to equity interest holders notwithstanding that the class of second lien claims which included secured claims and unsecured deficiency claims accepted the plan less than unanimously. Slip op. at 1n.3, 45-56.

### ***B. Limits and Extensions of SPM***

i. After *Armstrong*, Secured Claimholders Can Still Voluntarily Cede Collateral Proceeds to General Creditors, Skipping Priority Creditors (*In re World Health Alternatives*, Case No. 06-10166 (Bankr. D. Del., July 7, 2006))

In *In re World Health Alternatives*, Case No. 06-10166 (Bankr. D. Del., July 7, 2006), the prepetition secured lender granted a postpetition loan subject to the right of creditors to challenge the allowability of its prepetition claim within certain time limits. The rights of all creditors other than the statutory creditors' committee to challenge the claim expired. Meanwhile, the debtor moved to sell substantially all the estate's assets and the prepetition lender attempted to be the stalking horse bidder.

Subject to bankruptcy court approval, the committee agreed to withdraw its objection to the sale and to some of the prepetition lender's liens and to release certain claims, in exchange for \$1.625 million from the lender, which the committee could use to prosecute actions to benefit all creditors of the estate or to distribute to the general prepetition creditors, skipping the IRS tax claim in excess of \$4 million. Prior to an uncontested conversion of the case to chapter 7, the debtors and the committee requested approval of the agreement over the United States trustee's objection. The IRS did not object.

The crux of the United States trustee's objection was that the committee "is not authorized to borrow and/or compromise estate claims and causes of action at the expense of priority creditors in chapter 11." Slip Op. at 12. The bankruptcy court overruled the objection, holding:

"Although the general unsecured creditors will receive money before the priority creditors, that money does not belong to the estate – it belongs to CapSource. See *Official Comm. of Unsecured Creditors v. Stern (In re SPM Mfg. Corp.)*, 984 F.2d 1305, 1313 (1st Cir. 1993). In other words, the payout to the general unsecured creditors is a carve out of the secured creditor's lien and not estate property. I believe the Bankruptcy Code does not prohibit this arrangement and reported cases so hold. *Id.* at 1313."

Slip. op. at 12-13. The bankruptcy court explained *Armstrong* did not apply because the settlement *World Health* was not arising in a chapter 11 plan implicating the absolute priority rule, the secured lender could distribute its own proceeds, and the distribution was a carve out from the lien. Slip. op. at 15-16.

Notably, parties should not and can not be allowed to evade the absolute priority rule by doing something in a court approved settlement as opposed to a plan. But, the bankruptcy court's other rationales for approving the settlement are valid because unlike *Armstrong* where creditors were being compelled to part with a portion of their entitlements, in *World Health* the secured lender was doing it voluntarily.

The United States trustee's most potent argument was that the estate's defenses and causes of action should not be used to benefit general creditors before priority creditors. Significantly, the IRS could have prevented that result by itself objecting to the lender's liens and thereby placing itself in the way of a deal between the lender and the committee. It allowed its rights to expire. The bankruptcy court did not take sides on the issue of whether the committee owed fiduciary duties to priority creditors contrary to substantial authority,<sup>1</sup> but did opine that refusal to approve the settlement would only help the secured lender.

ii. Transferring Property Outside a Chapter 11 Plan May Be Permissible when The Same Transfers Inside a Plan May be Barred

In *SPM*, the secured claimholder transferred a portion of its collateral proceeds in chapter 7 and the appeals court approved it while questioning whether the bankruptcy

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<sup>1</sup> *In re SPM*, 984 F.2d 1305, 1316 (1st Cir. 1993); *Official Dalkon Shield Claimants' Comm. v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 769, 771 (4th Cir. 1989); *In re Int'l Swimming Pool Corp.*, 186 F.Supp. 63, 64 (S.D.N.Y. 1960); *Creditors' Comm. of Trantex Corp. v. Baybank Valley Trust Co., (In re Trantex Corp.)*, 10 B.R. 235, 238 (Bankr. D. Mass. 1981).

court could be further involved in the actual distribution of funds and determination of claims of the unsecured claimant recipients. 974 F.2d at 1319.

In *In re Sentry Operating Co. of Texas*, 264 B.R. 850 (Bankr. S.D. Tex. 2001), the secured claimholder allowed a portion of its collateral to be paid to one of two classes of unsecured claims pursuant to a proposed chapter 11 plan. The recipient class would receive 100% recovery while the other class would receive a 1% recovery. 264 B.R. at 855. The debtor's rationale for the different treatment was that the class being paid 100% contained local trade creditors and the funeral home operations would terminate or suffer if they were not paid. The court found the debtor's president's testimony to that effect credible and true. 264 B.R. at 856.

The court ruled the rationale for separate classification was valid, but the actual classification was invalid under 11 U.S.C. § 1122 because the class being paid 100% contained many national creditors whose payment was not tied to maximizing the value of estate assets. 264 B.R. at 861. The court also held the different treatment of the two classes of unsecured claims constituted unfair discrimination under 11 U.S.C. § 1129(b) because a secured creditor can not decide which creditors get paid without reference to fairness. 264 B.R. at 865.

Accordingly, while no law prevents the secured creditor from paying certain local trade creditors outside a chapter 11 plan, putting their payment into the plan made a difference. The dilemma faced by the debtor was likely that without a separate classification in the plan, it would not obtain an impaired accepting class of unsecured claims for purposes of 11 U.S.C. § 1129(a)(10). But, the plan could easily have impaired the secured claimholder who could provide the impaired accepting class.

Similarly, in *In re Snyders Drug Stores, Inc.*, 307 B.R. 889 (Bankr. N.D. Ohio 2004), the chapter 11 plan proposed by the debtor and creditors' committee contained 3 classes of unsecured claims: one for reclamation claimants, one for trade creditors, and one for landlord claims. The reclamation claimants would receive 27% distributions, the trade creditors 6-7%, and the landlords 0%. 307 B.R. at 892. The plan proponents argued against an unfair discrimination objection that the return to the unsecured claims was not property of the estate. The court ruled it was and sustained the objection, reasoning *SPM* did not apply because its distribution was outside a plan and was not from property of the estate. 307 B.R. at 896.

### iii. Some Courts Allow Senior and Secured Creditors to Use Chapter 11 Plans to Reallocate Their Distributions to Other Creditors Not Otherwise Entitled to Them

By contrast, in *In re Parke Imperial Canton, Ltd.*, 1994 Bankr. LEXIS 2274 (Bankr. N.D. Ohio 1994), two secured claimholders proposed a chapter 11 plan under which the estate's hotel leasehold would be sold with the proceeds allocated to the secured claimholders, except for amounts a secured claimholder may use to satisfy its guaranty to one class of unsecured claimholders that it would receive at least a 10%

return. The court did not sustain an objection that the plan discriminated unfairly by providing one class of claims a 10% guarantee, reasoning that the guarantee would not be paid from estate assets and was allowed under *SPM*. 1994 Bankr. LEXIS 2274 at \*32-33.

Similarly, in *In re MCorp Financial, Inc.*, 160 B.R. 941 (S.D. Tex. 1993), the court confirmed a chapter 11 plan under which the FDIC received a distribution of \$33.054 million in settlement of its claims against the estate and the estate's counterclaims, 160 B.R. at 948, based on the rationale that the FDIC could receive a higher distribution than the estate's subordinated bondholders who were subordinate to senior bondholders, but not to the FDIC, based on *SPM*. 160 B.R. at 960. Because the senior bondholders accepted the plan under which the FDIC received a distribution that would otherwise have increased only the senior bondholders' distribution, the court confirmed the plan, reasoning: "That the creditor [in *SPM*] was secured is not relevant; it was the creditor's status as prior to the IRS that allowed it to share with those under the IRS, just as the seniors' priority over the juniors allows them to fund the FDIC settlement." 160 B.R. at 960.

Citing *MCorp* and *SPM*, *In re Genesis Health Ventures, Inc.*, 266 B.R. 591 (Bankr. D. Del. 2001), overruled an objection to classification under a chapter 11 plan that separately classified punitive damage claims from other unsecured claims and provided no distribution to the punitive damage claims (except from insurance proceeds) while providing a 7.34% dividend in stock to other unsecured claims, because the secured claimholders held liens against all estate assets and were not being paid in full. 266 B.R. at 598, 601-602.

Notably, while the foregoing decisions allow secured and senior claimholders to use a chapter 11 plan to distribute distributions of theirs to other creditors, they do not explicitly hold such distributions are exempt from classification and unfair discrimination restrictions.

### **3. Releases of Non-Debtors**

#### **A. *The General Rule.***

For constitutional reasons, the bankruptcy court generally and often can not discharge nondebtors. First, exercise of the bankruptcy power to discharge debt can not be constitutionally accomplished absent a contemporaneous fair allocation of the debtor's assets to the debtor's creditors. *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 450, 452, 455 (1937). Second, Bankruptcy Code section 524(e) provides the debtor's discharge does not discharge nondebtors, as follows:

“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.”<sup>2</sup>

See, e.g., *American Hardwood, Inc. v. Deutsche Credit Corp. (In re American Hardwoods Inc.)*, 885 F.2d 621, 626 (9th Cir. 1989); *Lansing Diversified Properties-II v. First Natl Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592 (10th Cir. 1990), modified on other grounds, 932 F.2d 898 (10th Cir. 1991); *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985); *Consolidated Motor Inns v. BVA Credit Corp. (In re Consolidated Motor Inns)*, 666 F.2d 189 (5th Cir. 1982) *Union Carbide Corp. v. Newboles*, 686 F.2d 593 (7th Cir. 1982).

As shown below, the circuit courts differ as to whether and under what circumstances the bankruptcy court can discharge or release nondebtors. One simple cause of the dispute is that some courts start the analysis by asking the constitutional question, while other courts skip that step and start by looking at the statutory jurisdictional grant to the bankruptcy court. Because 11 U.S.C. § 1334(b) broadly grants the bankruptcy court power over all civil proceedings "related to cases under title 11," it is clear the court has the raw statutory power to grant discharges to nondebtors.

The courts that start their analysis with section 1334(b) next wrestle with the unfairness of a nondebtor obtaining a discharge or a release from certain liability without subjecting its assets to the provisions of title 11. 11 U.S.C. § 105(a) empowers the court to “issue any order...necessary or appropriate to carry out the provisions of” title 11. Given that title 11 prescribes an elaborate set of requirements before any entity can receive a discharge, the question becomes whether granting a nondebtor a discharge of one or more debts without satisfying all title 11 requirements is consonant with section 105(a). Courts granting such discharges or releases attempt to limit the unfairness by restricting such discharges to situations where they are necessary for the reorganization and are unlikely to harm creditors materially.

Bankruptcy Rule 3016(c)<sup>3</sup> requires the plan and disclosure statement, if the plan enjoins conduct not otherwise enjoined by the Bankruptcy Code, to disclose in bold, italic, or underlined text "all acts to be enjoined and identify the entities that would be subject to the injunction." Normally, releases are accompanied by injunctions against

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<sup>2</sup>Bankruptcy Code section 547(d) purports to discharge a surety to the extent the surety bonded an obligation and received collateral security for its reimbursement right and the lien would have been avoidable.

<sup>3</sup> Bankruptcy Rule 3016(c) provides:

*Injunction under a Plan.* If a plan provides for an injunction against conduct not otherwise enjoined under the Code, the plan and disclosure statement shall describe in specific and conspicuous language (bold, italic, or underlined text) all acts to be enjoined and identify the entities that would be subject to the injunction.

suing to enforce the released claims. Bankruptcy Code section 524(a)(2) automatically imposes an injunction against enforcing claims against the debtor or estate that are discharged pursuant to section 1141(d)(1)(A).

***B. Res Judicata.***

Notwithstanding the illegalities of discharging nondebtors, when it does occur on notice to an affected creditor and is not reversed, the discharge is binding due to *res judicata* and may not be collaterally attacked except perhaps in extraordinary circumstances. *Travelers Indemnity Co. v. Bailey*, 129 S. Ct. 2195 (2009); *Stoll v. Gottlieb*, 305 U.S. 165 (1938); *Levy v. Cohen*, 19 Cal. 3d 165 (Sup. Ct. 1977).

Significantly, notice of the discharge must pass constitutional muster and the rules. In *Century Indemnity Co. v. National Gypsum Company Settlement Trust (In re National Gypsum Company)*, 208 F.3d 498 (5<sup>th</sup> Cir. 2000), *cert. denied*, 121 S.Ct. 172 (2000), the reorganized debtor asserted it discharged the cure amount claim of the nondebtor party to one of its executory contracts by providing in its chapter 11 plan that the contract to be assumed had a cure amount of zero. The evidence on summary judgment did not show the nondebtor party had notice other than a general notice of the pendency of the chapter 11 case.

On appeal, the Fifth Circuit affirmed the district court's affirmance of the bankruptcy court and held "§ 1141(d) cannot be read to provide for discharge of amounts in default under assumed contracts in a manner that would nullify the cure requirement of section 365(b)(1)." 208 F.3d at 509.

But, the bankruptcy court had also held the nondebtor party was bound to the zero cure amount based on *res judicata*. The district court reversed and the Fifth Circuit affirmed the reversal. Notably, the appellate courts did not require that the nondebtor party receive a standalone motion to assume listing the cure amount as zero. Rather, the Fifth Circuit held "the debtor must demonstrate delivery of the proposed plan of reorganization or some other court-ordered notice that set forth National Gypsum's intent to assume the Wellington Agreement with a \$0 cure amount." 208 F.3d at 513. The court approved other decisions holding the "motion to assume was 'made' when the non-debtor party to the lease was served notice of the plan's filing." 208 F.3d at 513 (citing *Riddle v. Aneiro (In re Aneiro)*, 72 B.R. 424, 428 (Bankr. S.D. Cal. 1987); *In re Hall*, 202 B.R. 929, 932-933 (Bankr. W.D. Tenn. 1996).

***C. In re Ingersoll, Inc., 562 F.3d 856 (7<sup>th</sup> Cir. 2009)***

i. Facts

Ingersoll Cutting Tool Company ("ICTC"), and its parent company, Ingersoll International, Inc. ("Ingersoll") had been controlled by the Gaylords. When the Gaylords learned that the outside ceo and directors were trying to cause ICTC to be sold, the Gaylords retained a law firm to stop the sale, 562 F.3d at 859, which firm explained it

would need help from an attorney at another firm. 562 F3d at 859. The parties negotiated fee arrangements that led to multiple disputes down the road. Ultimately, ICTC was sold and Ingersoll ended up in chapter 11.

Ultimately, Ingersoll's liquidation plan was confirmed and contained a release of the Gaylords, providing the Gaylords:

"shall be released from any and all claims and causes of action by all creditors, parties-in-interest, directors, officers, shareholders, agents, affiliates, parent entities, successors, assigns, predecessors, members, partners, managers, employees, insiders, agents and representatives of the Debtors and their estates arising from or relating to the Gaylord Actions, including, without limitation, any claims causes of action, and counterclaims by any present or former party to any of the Gaylord Actions."

562 F.3d at 862. One of the Gaylords' attorneys was served with a copy of the confirmed chapter 11 plan, but nevertheless sued the Gaylords in state court contending the Gaylords were breaching their arbitration agreement by suing the attorney in state court. 562 F.3d at 862. The Gaylords requested the bankruptcy court to enjoin the attorney from suing them and to hold the attorney in contempt. The bankruptcy court held the attorney's suit was within the release language in the chapter 11 plan and enjoined him from pursuing his claim, and also held the plan's release of the (nondebtor) Gaylords from claims of the (noncreditor) attorney was valid because it was central to the negotiation and ultimate success of the plan. 562 F.3d at 862-863.

The district court remanded the attorney's appeal for the bankruptcy court to determine if the attorney was a creditor of the debtor. 562 F.3d at 863. On remand, the bankruptcy court ruled the attorney was not a creditor, but that the release was needed to ensure the success of the bankruptcy plan and he did not change his ruling that the release was proper. Then, the district court affirmed. 562 F.3d at 863.

ii. Issues

1. Was the release "by its terms broad enough to cover [the attorney's] claim?
2. Was the release legally valid even though it released a nondebtor from claims of entities who were not creditors of the debtor?

iii. Holdings

1. Yes. 562 F.3d at 864.
2. Yes. 562 F.3d at 863.

3. "Yet, it is important to note in all this what we are *not* saying. We are not saying that a bankruptcy plan purporting to release a claim like Miller's is always – or even normally – valid. In the unique circumstances of this case, however, we believe it is. We go no further than to apply the rule we adopted in *Airadigm* to the facts at hand. In most instances, releases like the one here will not pass muster under that rule. Bankruptcy litigants should keep that in mind when they sit down at the negotiating table." 562 F.3d at 865.

#### iv. Rationale

Section 105 of title 11 "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]." 562 F.3d at 864. "This 'residual authority' is consistent with a bankruptcy court's 'traditionally broad' equitable powers, *In re Airadigm Comm., Inc.*, 519 F.3d 640, 657 (7<sup>th</sup> Cir. 2008)..." 562 F.3d at 864. The equitable powers "also make an appearance within the context of reorganization plans. Similar to § 105, 11 U.S.C. § 1123(b)(6) allows a court to include in a plan 'any other appropriate provision not inconsistent with the applicable provisions of [the bankruptcy code]." 562 F.3d at 864.

"[T]he release does not provide blanket immunity. As in *Airadigm* – and in contrast to *Metromedia* – it is narrowly tailored and critical to the plan as a whole. The release only covers claims arising from or relating to two cases (the Gaylord Actions), so it is far from a full-fledged 'bankruptcy discharge arranged without a filing and without the safeguards of the Code.'...Just as importantly, the bankruptcy court found that the release was an 'essential component' of the plan, the fruit of 'long-term negotiations' and achieved by the exchange of 'good and valuable consideration' by the Gaylords that 'will enable unsecured creditors to realize distribution in this case.'" 562 F.3d at 865.

"When the plan was confirmed (following an objection period), the debtors served copies of the plan on creditors and parties in interest. Miller received a copy as a party-in-interest." 562 F.3d at 862.

#### v. Analysis

The appellate decision analyses the issue from the viewpoint of whether the release of a nondebtor is authorized by sections 105 and 1123. The decision skips right to the statute, and nowhere asks whether the bankruptcy power granted in article I of the U.S. Constitution grants authority to Congress to pass laws discharging nondebtors from any claims. While the court does observe that the release of the Gaylords was not a blanket release, thereby not creating a discharge without the Gaylords abiding by all the other provisions of title 11, the court does not determine whether the power granted to Congress to discharge debtors, can be applied to nondebtors. Indeed, in *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 450, 452, 455 (1937), the Supreme Court ruled exercise

of the bankruptcy power to discharge debt can not be constitutionally accomplished absent a contemporaneous fair allocation of the debtor's assets to the debtor's creditors. *Accord ACC Bondholder Group v. Adelphia Communications Corp. (In re Adelphia Communications Corp.)*, 361 B.R. 337, 358n. 98 (S.D.N.Y. 2007)(" In order for the implementation of the Bankruptcy law to be constitutional, it must provide for a fair distribution of assets to a debtor's creditors. See *Kuehner v. Irving Trust Co.*, 299 U.S. 445, 451, 57 S. Ct. 298, 81 L. Ed. 340 (1937).).

Finally, the attorney who lost his claim against the nondebtors, received a copy of the confirmed plan, but the facts do not show he received a copy in time to object to confirmation. Conversely, the decision does not discuss that issue, so the attorney presumably did not raise it on appeal. Perhaps the attorney did not raise it because he was able to argue his objection to the bankruptcy court when the issue arose after confirmation.

**D. *Airadigm Communications, Inc. v. Federal Communications Commission (In re Airadigm Communications, Inc.)*, 519 F.3d 640 (7<sup>th</sup> Cir. 2008)**

i. Facts

During Airadigm's first chapter 11 case commenced in 1999, the FCC cancelled Airadigm's personal communications services licenses which Airadigm had purchased at a 1996 auction for cash and debt. Airadigm owed the FCC \$64.2 million when it commenced its chapter 11 case. That case resulted in a confirmed chapter 11 plan that assumed the FCC had properly cancelled the licenses. The chapter 11 plan was financed by Telephone and Data Systems ("TDS"), which would pay the FCC different amounts on its proof of claim depending on whether the FCC would reinstate the licenses during two years after confirmation.

Then, in 2003, the United States Supreme Court decided *FCC v. NextWave Personal Communications, Inc.*, 537 U.S. 292 (2003), where it overturned the FCC's license cancellation in similar circumstances to Airadigm and the FCC acknowledged its cancellation of the Airadigm licenses was ineffective. Airadigm then commenced a second chapter 11 case in 2006 and commenced an adversary proceeding against the FCC requesting a divesting of the FCC of any further interest in the licenses. The bankruptcy court granted the FCC summary judgment rejecting Airadigm's claims.

Later in 2006, the bankruptcy court confirmed Airadigm's chapter 11 plan. Based on the licenses then being worth \$33 million, the plan treated the FCC as having a \$33 million secured claim and a deficiency claim for the balance of the \$64.2 million. The FCC could take an immediate payout of \$33 million and lose its liens in the licenses, or it could make the section 1111(b)(2) election. If it made the election, the debtor would purchase and hold \$33 million of government-backed or low risk securities having different maturities, such that over time (no more than 30 years) the principal and interest from the securities would pay the FCC \$64.2 million. If the reorganized debtor

were to sell the licenses, the FCC would receive the sale proceeds, and if less than \$64.2 million, would retain its lien against the licenses.

The FCC objected to its treatment. First, it objected that its lien was not being preserved because its regulations provided that on a sale, the entire balance becomes due. Second, the FCC objected to the plan's release of its third party financier from "any act or omission arising out of or in connection with the...confirmation of this Plan...except for willful misconduct." The bankruptcy court determined that without the financier the debtor would have to finance \$188 million and the financier would not go forward without the release.

ii. Issues

1. Airadigm asserts its first chapter 11 plan extinguished the FCC's liens.
2. Airadigm also asserts the FCC's interests in the licenses were avoidable by its strongarm powers.
3. The FCC challenged the interest rate being paid on its claim if it made the section 1111(b)(2) election.
4. The FCC contended its liens were not being preserved due to the absence of a 'due-on sale' sale clause in the plan.

iii. Holdings

1. Airadigm's first chapter 11 plan did not extinguish the FCC's liens.
2. Airadigm's strongarm powers can not avoid the FCC's liens.
3. The FCC waived its interest rate argument by not raising it in the bankruptcy court.
4. The FCC's liens were preserved because the due-on sale clause is not part of the lien.

"In light of these provisions, we hold that this 'residual authority' permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code."

iv. Rationale

Bankruptcy Code section 1141(c) provides that "after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors..." But for the plan to 'deal[ ] with' property for purposes of § 1141(c), the plan itself must give some indication that it has compensated the creditor for or otherwise impliedly

affected its interest...." Here, the plan assumed the licenses were cancelled and did not deal with them.

Bankruptcy Code section 544(a)(1) provides Airadigm the "rights and powers of ... a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien" against the property. If a hypothetical creditor could have obtained an interest superior to the FCC's at the time of Airadigm's filing, the FCC would be an unsecured claimholder.

Here, "the property itself – the license – is a creature of federal law. Accordingly, federal law also defines the FCC's retained interest in that license....And as defined by federal law, the FCC does not have to perfect its interest in a spectrum license because federal law prevents another creditor from holding a superior interest. \*\*\* These statutory and regulatory provisions indicate that federal law precludes a private party from obtaining a superior interest to the FCC. \*\*\* But if the forced sale of the PCS licenses were to occur with the FCC as merely an unperfected secured creditor, the sale would conflict with the statutes and regulations covering the FCC's licensing scheme. This conflict gives rise to a negative inference – controlling in this case – that federal law does not allow private creditors to obtain an interest in PCS licenses superior to the FCC's...."

"The due-on-sale provisions contained in the FCC's regulations do not constitute part of its lien that the bankruptcy court had to 'retain' in order to approve the plan pursuant to § 1129. The bankruptcy code [sic] defines a 'lien' as a 'charge against or interest in property to secure payment of a debt or performance of an obligation.' 11 U.S.C. § 101(37). The due-on-sale provision contained in the federal regulation is not a 'charge against or interest in property' but is instead a regulation regarding the terms of payment for the debt...."

Section 524(e) is a savings clause and provides the "discharge of a debt of the debtor does not affect the liability of another entity on, or the property of any other entity for, such debt." If section 524(e) were meant to limit the bankruptcy court's power to release a nondebtor it would have said the discharge of a debtor shall not affect the liability of another entity. In contrast, section 34 of the Bankruptcy Act of 1898, as amended, provided: "[t]he liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt." Thus, *Union Carbide Corp. v. Newboles*, 686 F.2d 593 (7<sup>th</sup> Cir. 1982)(all nondebtor releases were prohibited under the prior version of the Bankruptcy Code), "is no longer controlling on this point of view."

"...Section 1123(b)(6) permits a court to 'include any other provision not inconsistent with the applicable provisions of this title.'...In light of these provisions, we hold that this 'residual authority' permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code."

v. Analysis

Both section 524(e) and its predecessor, section 34, solely provide that the debtor's discharge does not discharge liability of a third party. The distinction the court makes between section 34 which uses the word "shall" and section 524(e) which does not, is a distinction without a difference because neither section talks to the court's power to release third parties. Accordingly, by bypassing the constitutional issue and by overlooking the big picture, namely that the Bankruptcy Code has an elaborate set of requirements preceding the release of liability which is not satisfied by the nondebtor, the court manages to conclude the court is empowered to and can validly release a nondebtor.

As a practical matter, however, there is nothing in the facts indicating the FCC or any creditor had any claim against the financier. The bankruptcy court clearly could have ordered that any claims against the financier arising out of the chapter 11 case be filed in its court by a date certain. Thus, the equivalence of the release could likely have been achieved.

***E. Travelers Indemnity Co. v. Bailey, 129 S. Ct. 2195 (2009)***

i. Facts

As what was called the "cornerstone" of the reorganization, and as part of Johns-Manville Corp.'s ("Manville") settlement with its insurers for \$770 million, Travelers, as Manville's primary insurer, paid nearly \$80 million. 129 S. Ct. at 2199. "There would have been no such payment without the injunction" providing "all Persons are permanently restrained and enjoined from commencing and/or continuing any suit, arbitration or other proceeding of any type or nature for Policy Claims against any or all members of the Settling Insurer Group." 129 S. Ct. at 2199. "Policy Claims" were defined as "any and all claims, demands, allegations, duties, liabilities and obligations (whether or not presently known) which have been, or could have been, or might be asserted by any Person against ...any or all members of the Settling Insurer Group based upon, arising out of or relating to any or all of the Policies." *Id.*

Various plaintiff groups subsequently filed direct action lawsuits against Travelers and other insurers on a variety of legal theories falling into two broad categories: violation of state consumer-protection statutes by conspiring with other insurers and asbestos manufacturers to hide dangers of asbestos and to raise a fraudulent 'state of the art' defense to personal injury claims; and violation of common law duties by failing to warn the public about the dangers of asbestos or by acting to keep its knowledge of those dangers from the public. 129 S. Ct. at 2200.

Travelers requested the bankruptcy court to enjoin the lawsuits. 129 S. Ct. at 2200. After a mediation, 3 classes of plaintiffs settled with Travelers paying over \$400 million. *Id.* The settlements were conditioned on entry of a bankruptcy court order

clarifying that the direct action lawsuits are and have always been prohibited by the 1986 confirmation order and related orders. *Id.* The bankruptcy court issued the order after finding that Travelers learned virtually everything it knew about asbestos from its relationship with Manville and that "[t]he gravamen of [the] Direct Action Claims were acts or omissions by Travelers arising from or relating to Travelers['] insurance relationship with Manville." 129 S. Ct. at 2201. The bankruptcy court also reasoned that the Second Circuit's earlier decision, *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 93-94 (2d Cir. 1988), was controlling. 129 S. Ct. at 2202. That decision rejected a claim that the provisions of the confirmation order and settlement order exceeded the bankruptcy court's jurisdiction.

## ii. Issues

1. After the bankruptcy court confirmed Manville's chapter 11 plan and enjoined certain lawsuits against Manville's insurers including Travelers, does the injunction bar "state-law actions against Travelers based on allegations either of its own wrongdoing while acting as Manville's insurer or of its misuse of information obtained from Manville as its insurer? 129 S. Ct. at 2198.

2. "...[W]hether the Bankruptcy Court had subject-matter jurisdiction to enter the Clarifying Order." 129 S. Ct. at 2205.

## iii. Holdings

1. "We hold that the terms of the injunction bar the actions and that the finality of the Bankruptcy Court's orders following the conclusion of direct review generally stands in the way of challenging the enforceability of the injunction." 129 S. Ct. at 2198.

2. "...The answer is easy: as the Second Circuit recognized, and respondents do not dispute, the Bankruptcy Court plainly had jurisdiction to interpret and enforce its own prior orders. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 239, 54 S. Ct. 695, 78 L. Ed. 1230 (1934)..." 129 S. Ct. at 2205.

"Our holding is narrow. We do not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor insurers that are not derivative of the debtor's wrongdoing. As the Court of Appeals noted, in 1994 Congress explicitly authorized bankruptcy courts, in some circumstances, to enjoin actions against a nondebtor 'alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor to the extent such alleged liability . . . arises by reason of . . . the third party's provision of insurance to the debtor or a related party,' and to channel those claims to a trust for payments to asbestos claimants. 11 U.S.C. § 524 (g)(4)(A)(ii). On direct review today, a channeling injunction of the sort issued by the Bankruptcy Court in 1986 would have to be measured against the requirements of § 524 (to begin with, at least). But owing to the posture of this litigation, we do not address the scope of an injunction authorized by that section."<sup>8</sup>

8 Section 524(h) provides that under some circumstances § 524(g) operates retroactively to validate an injunction. We need not decide whether those circumstances are present here.

Nor do we decide whether any particular respondent is bound by the 1986 Orders. We have assumed that respondents are bound, but the Court of Appeals did not consider this question. Chubb, in fact, relying on *Amchem Products, Inc. v. Windsor*, 521 U.S. 591, 117 S. Ct. 2231, 138 L. Ed. 2d 689 (1997), and *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 119 S. Ct. 2295, 144 L. Ed. 2d 715 (1999), has maintained that it was not given constitutionally sufficient notice of the 1986 Orders, so that due process absolves it from following them, whatever their scope. See 340 B. R., at 68. The District Court rejected this argument, *id.*, at 68-69, but the Court of Appeals did not reach it, 517 F.3d at 60, n. 17. On remand, the Court of Appeals can take up this objection and any others that respondents have preserved." 129 S. Ct. at 2207.

#### iv. Rationale

"Respondents seek further refuge in evidence that before entry of the 1986 Orders some parties to the Manville bankruptcy (including Travelers) understood the proposed injunction to bar only claims derivative of Manville's liability. They may well be right about that: we are in no position to engage in factfinding on this point, but there certainly are statements in the record that seem to support respondents' contention. See App. for Respondent Chubb 1a-3a, 5a, 13a-14a. But be that as it may, where the plain terms of a court order unambiguously apply, as they do here, they are entitled to their effect. See, e.g., *Negron-Almeda v. Santiago*, 528 F.3d 15, 23 (CA1 2008) ('[A] court must carry out and enforce an order that is clear and unambiguous on its face'); *United States v. Spallone*, 399 F.3d 415, 421 (CA2 2005) ('[I]f a judgment is clear and unambiguous, a court must adopt, and give effect to, the plain meaning of the judgment' (internal quotation marks omitted)). If it is black-letter law that the terms of an unambiguous private contract must be enforced irrespective of the parties' subjective intent, see 11 R. Lord, *Williston on Contracts* § 30:4 (4th ed. 1999), it is all the clearer that a court should enforce a court order, a public governmental act, according to its unambiguous terms. This is all the Bankruptcy Court did." 129 S. Ct. at 2204.

"Those orders are not any the less preclusive because the attack is on the Bankruptcy Court's conformity with its subject-matter jurisdiction, for '[e]ven subject-matter jurisdiction . . . may not be attacked collaterally.' *Kontrick v. Ryan*, 540 U.S. 443, 455, n. 9, 124 S. Ct. 906, 157 L. Ed. 2d 867 (2004). See also *Chicot County Drainage Dist. v. Baxter State Bank*, 308 U.S. 371, 376, 60 S. Ct. 317, 84 L. Ed. 329 (1940) ('[Federal courts] are courts with authority, when parties are brought before them in accordance with the requirements of due process, to determine whether or not they have jurisdiction to entertain the cause and for this purpose to construe and apply the statute under which they are asked to act. Their determinations of such questions, while open to direct review, may not be assailed collaterally'). So long as respondents or those in privity with them were parties to the Manville bankruptcy proceeding, and were

given a fair chance to challenge the Bankruptcy Court's subject-matter jurisdiction, they cannot challenge it now by resisting enforcement of the 1986 Orders. See *Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702, n. 9, 102 S. Ct. 2099, 72 L. Ed. 2d 492 (1982) ('A party that has had an opportunity to litigate the question of subject-matter jurisdiction may not . . . reopen that question in a collateral attack upon an adverse judgment'); *Chicot County, supra*, at 375, 60 S. Ct. 317, 84 L. Ed. 329 ('[T]hese bondholders, having the opportunity to raise the question of invalidity, were not the less bound by the decree because they failed to raise it').<sup>6</sup>

6 The rule is not absolute, and we have recognized rare situations in which subject-matter jurisdiction is subject to collateral attack. See, e.g., *United States v. United States Fidelity & Guaranty Co.*, 309 U.S. 506, 514, 60 S. Ct. 653, 84 L. Ed. 894 (1940) (a collateral attack on subject-matter jurisdiction is permissible "where the issue is the waiver of [sovereign] immunity"); *Kalb v. Feuerstein*, 308 U.S. 433, 439-440, 444, 60 S. Ct. 343, 84 L. Ed. 370 (1940) (where debtor's petition for relief was pending in bankruptcy court and federal statute affirmatively divested other courts of jurisdiction to continue foreclosure proceedings, state-court foreclosure judgment was subject to collateral attack). More broadly, the *Restatement (Second) of Judgments* § 12, p. 115 (1980), describes three exceptional circumstances in which a collateral attack on subject-matter jurisdiction is permitted:

'(1) The subject matter of the action was so plainly beyond the court's jurisdiction that its entertaining the action was a manifest abuse of authority; or

'(2) Allowing the judgment to stand would substantially infringe the authority of another tribunal or agency of government; or

'(3) The judgment was rendered by a court lacking capability to make an adequately informed determination of a question concerning its own jurisdiction and as a matter of procedural fairness the party seeking to avoid the judgment should have opportunity belatedly to attack the court's subject matter jurisdiction.'

This is no occasion to address whether we adopt all of these exceptions. Respondents do not claim any of them, and we do not see how any would apply here. This is not a situation, for example, in which a bankruptcy court decided to conduct a criminal trial, or to resolve a custody dispute, matters "so plainly beyond the court's jurisdiction" that a different result might be called for." 129 S. Ct. at 2205-2206.

v. Does *Travelers* Implicitly Overrule *Metromedia* and *Drexel Burnham*?

Significantly, the Supreme Court reversed the Second Circuit's holding that the bankruptcy court's injunction could be collaterally attacked. By doing so, the Supreme Court had no occasion to opine on whether the Second Circuit's underlying reasoning was correct that a bankruptcy court lacks subject matter jurisdiction to release claims against a non-title 11 debtor which were not derivative of the title 11 debtor's wrongdoing. Indeed, the Supreme Court expressly announced it was not resolving that

issue. 129 S. Ct. at 2207. Therefore, it is possible that the Second Circuit has narrowed or changed its previous jurisprudence allowing third party releases important to the reorganization.

Previously, the Second Circuit has acknowledged the bankruptcy court's subject matter jurisdiction to grant third party releases when they are important to the reorganization. "[A] court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan." *Drexel Burnham Lambert Trading Corp. v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992).

Fundamentally, the words of the grant of subject matter jurisdiction to the bankruptcy court encompass the granting of third party releases because they are so broad. Pursuant to 28 U.S.C. § 1334(b), subject matter jurisdiction is granted "of all civil proceedings arising under title 11, or arising in or related to cases under title 11." At a minimum, the grant of a third party release to a nondebtor that injects cash into the estate, is "related to" the case. As the United States Supreme Court observed in *Celotex Corp. v. Edwards*, 514 U.S. 300,308 (1995), Congress' choice of the words "related to" "suggests a grant of some breadth," and "must be read to give district courts...jurisdiction over more than simply proceedings involving the property of the debtor or the estate." The court noted the test of *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) for related to jurisdiction: "The usual articulation of the test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of *that proceeding could conceivably have any effect on the estate being administered in bankruptcy*.... Thus the proceeding need not necessarily be against the debtor or against the debtor's property. 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." (emphasis supplied by *Pacor*). But, the impediments to third party releases are the constitutional concerns listed above and the danger of abuse alluded to below in *Metromedia*.

The question at hand is whether the portion of the Second Circuit's decision in *Johns-Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 517 F.3d 52 (2d cir. 2008), rev'd, 129 S. Ct. 2195 (2009), that was not reached by the Supreme Court eliminates the Second Circuit's holdings in *Drexel* and *Metromedia* that releases of third parties from claims that are not paid from estate assets are still available when "important" to the reorganization. In *Drexel*, the Second Circuit affirmed approval of a class action settlement with the debtor in possession under which one subclass was permanently enjoined from bringing any future actions against Drexel's directors and officers and another subclass was given the exclusive right to share in a portion of the settlement funds. *Drexel Burnham Lambert Trading Corp. v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 288-89 (2d Cir. 1992). The Second Circuit's decision reversed on jurisdictional grounds by *Travelers, sub silencio* harkens back to the old subject matter jurisdictional regimen under the Bankruptcy Act of 1898, as amended, which turned on property of the estate, the *res*.

The new statutory jurisdictional grant goes beyond limiting subject matter jurisdiction to the *res* as conceded in *Celotex, supra*. To be sure, in a case where insurance proceeds were very important as in *Manville*, had the issue arisen at confirmation as to whether Travelers and the other insurers would have entered into the settlement at the same amount if they had known their release would not include a release of claims not payable from their insurance policies, the answer would almost certainly have been no. Under the *Drexel* and *Metromedia* standard, their releases would have been approved under the 'important to reorganization' standard. The Second Circuit's decision reversed on jurisdictional grounds by *Travelers* makes it uncertain at best whether that standard has survived.

**F. *Deutsche Bank, AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136 (2d Cir. 2005)**

i. Facts.

Pursuant to MFN's chapter 11 plan, the Kluge Trust together with its insiders would receive a release from all claimholders against MFN of all claims arising out of any matter related to MFN or its affiliates through the effective date of the plan. *Deutsche Bank, AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005). In exchange for the release, the Kluge Trust would forgive approximately \$150 million of claims, convert \$15.7 million of senior secured claims to equity, invest \$12.1 million in the reorganized debtors and purchase up to \$25 million of common stock in the reorganized debtors. *Id.*

Additionally, the chapter 11 plan released former and current MFN personnel from claims related to the bankruptcy, except for claims based on gross negligence or willful misconduct, and from claims related to MFN, the debtors, or the chapter 11 plan. *Id.* at \*141n. 5.

ii. Issue.

Were the releases authorized by the Bankruptcy Code on the findings made by the bankruptcy court? *Id.* at 141.

iii. Holding.

No. *Id.* at 143. But, rather than remand to determine if findings can support the releases, the appeal must be dismissed for equitable mootness because reversal would be inequitable and appellants had neither sought a stay of the confirmation order nor sought an expedited appeal. *Id.* at 144.

iv. Rationale.

In bankruptcy, "a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan." *Drexel*

*Burnham Lambert Trading Corp. v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992).

Two considerations create a judicial reluctance to approve nondebtor releases. First, only section 524(g) of the Bankruptcy Code provides for nondebtor releases and section 105(a) cannot be used to create substantive rights. *Id.* at 142. Second, nondebtor releases lend themselves to abuse because nondebtors thereby obtain a bankruptcy discharge without the other safeguards of the Bankruptcy Code. *Id.*

Here, there was a finding below that the Kluge Trust made a material contribution to the estate, *id.* at \*143, but there was no finding the release itself was important to the plan or necessary for the plan. *Id.* “A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan...” *Id.*

Because the Kluge transaction can not be undone without violence to the overall agreement and the court can not predict what will happen if the settlement is altered, the appeal is equitably moot. *Id.* at 145.

***G. Lacy v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648 (6th Cir. 2002)**

i. Facts

Dow Corning proposed a chapter 11 plan under which Dow’s product liability insurers, Dow’s shareholders, and Dow’s operating reserves provided \$2.35 billion for payment of personal injury claimants, government health care payers, and other creditors asserting claims related to silicone-implant product liability claims. As a *quid pro quo*, Dow’s insurers and shareholders would be released from all further liability on claims arising out of settled personal injury claims and claimants would be permanently enjoined from bringing related claims against them. 280 F.3d at 255. The bankruptcy court interpreted the plan to mean the release and injunction would only apply to consenting claimants. But, the district court interpreted it to apply to all creditors and affirmed confirmation. 280 F.3d at 655-666.

ii. Issue

“Whether a bankruptcy court has the 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?” 280 F.3d at 656.

iii. Holding

“We hold that when the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor’s claims against a non-debtor: (1) There is an identity of interests between the debtor and the third party, usually an indemnity

relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions....” 280 F.3d at 658.

#### iv. Rationale

The Bankruptcy Code provides in section 105(a) that the bankruptcy court can issue any order necessary or appropriate to carry out the provisions of the Bankruptcy Code. 280 F.3d at 658. The statutory grant of power in section 105(a) renders *Grupo Mexicano v. Alliance Bond Fund Inc.*, 527 U.S. 308 (1999), inapplicable to bar equitable relief, and brings the case within the realm of *United States v. First National City Bank*, 379 U.S. 378 (1965), which upheld use of an injunction granted pursuant to a statute (26 U.S.C. § 7402(a)(1964)) granting courts power to issue injunctions “necessary or appropriate for the enforcement of the internal revenue laws.” 280 F.3d at 657-658. Notably, the court did not rely on the general jurisdictional grant in 28 U.S.C. § 1334.

### ***H. Gilman v. Continental Airlines (In re Continental Airlines), 203 F.3d 203 (3d Cir. 2000)***

#### i. Facts

During its chapter 11 case, Continental Airlines, with court approval, entered into a triparty agreement with its directors and officers insurers and directors and officers. Under the settlement, the insurers paid \$5 million to Continental. Continental released the insurers and the directors and officers. And, the directors and officers released Continental. Plaintiffs in then pending securities fraud class action suits against the directors and officers did not object to the settlement. Prior to the settlement, the bankruptcy court had temporarily restrained plaintiffs from prosecuting the directors and officers. Then, Continental’s chapter 11 plan released the directors and officers from plaintiffs’ claims and enjoined plaintiffs from pursuing them. Over plaintiffs’ objections the plan was confirmed and the confirmation was affirmed in the district court 5 years later.

#### ii. Holding

The United States Court of Appeals for the Third Circuit reversed the district court, holding “[p]laintiffs, who have never had their day in court, have been forced to forfeit their claims against non-debtors with no consideration in return,” 203 F.3d at 211, and the release and injunction were “legally unsupportable.” 203 F.3d at 218.

iii. Rationale

Without deciding whether non-debtor releases are never legal absent consent, or are legal when fair to the claimants and necessary to the reorganization, the court found there were no findings in the record to justify the release in either situation. 203 F.3d at 214.

First, there was nothing in the record showing the released directors and officers “provided a critical financial contribution to the Continental Debtors’ plan that was necessary to make the plan feasible in exchange for receiving a release of liability for Plaintiffs’ claims.” 203 F.3d at 215.

Second, the court questioned whether the reorganized debtor would really have to indemnify the directors and officers given that federal courts disfavor indemnity obligations for violating federal securities laws. 203 F.3d at 216.

Third, the court questioned the proposition that claims against the directors and officers would implicate the debtors’ insurance policy because the directors and officers may have direct rights to proceeds of the property. 203 F.3d at 216.

***I. Bruno’s, Inc. v. W.R. Huff Asset Management Co. (In re PWS Holding Corp.), 228 F.3d 224 (3d Cir. 2000)***

i. Facts

Pursuant to the confirmed chapter 11 plan for Bruno’s, Inc., fraudulent transfer claims against affiliates of the debtor’s shareholders and others were released. Additionally, the confirmation order provided:

“[n]one of the Debtors, the Reorganized Debtors, New Bruno’s, the Creditor Representative, the Committee or any of their respective members, officers, directors, employees, advisors, professionals or agents shall have or incur any liability to any holder of a Claim or Equity Interest for any act or omission in connection with, related to, or arising out of, the Chapter 11 Cases, the pursuit of confirmation of the Plan, the consummation of the Plan or the property to be distributed under the Plan, except for willful misconduct or gross negligence, and in all respects, the Debtors, the Reorganized Debtors, New Bruno’s, the Creditor Representative, the Committee and each of their respective members, officers, directors, employees, advisors, professionals and agents shall be entitled to rely upon the advice of counsel with respect to their duties and responsibilities under the Plan.” 228 F.3d at 246.

A holder of \$290 million of \$421 million of subordinated debt appealed the confirmation order on numerous grounds including (a) that the release of fraudulent transfer defendants violated the absolute priority rule, and (b) that the provision quoted above violates 11 U.S.C. §524(e) and the Third Circuit’s decision in *Gilman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203 (3d Cir. 2000).

## ii. Holding

The United States Court of Appeals for the Third Circuit affirmed the confirmation order because, among other things, the releases of avoidance claims were not on account of the shareholders' equity interests in the debtor and the protections afforded under the confirmation order are consistent with the standard of liability under the Bankruptcy Code. 228 F.3d at 229-230.

"[w]e announce a narrow rule that, without direct evidence of causation, releasing potential claims against junior equity does not violate the absolute priority rule in the particular circumstance in which the estate's claims are of only marginal viability and could be costly for the reorganized entity to pursue." 228 F.3d at 242.

## iii. Rationale

The examiner in the chapter 11 case had concluded the avoidance claims had little or no value. 228 F.3d at 242. Nevertheless, the objector had offered \$100,000 and sharing of proceeds in exchange for the claims. The appellate court affirmed their release for no consideration, reasoning "the District Court did not err in concluding that the potential cost of defending and paying indemnification claims, cross claims, and counterclaims arising out of the prosecution of the claims was high, and that the claims were extinguished not on account of KKR's interest in the Debtors, but because the Debtors determined that they were unlikely to have any value." 228 F.3d at 242. "[T]he claims were extinguished because, in the judgment of the plan proponents, extinguishment was the approach most likely to provide the greatest possible addition to the bankruptcy estate." *Id.*

The appellate court concluded the protections granted to the creditors' committee and professionals who rendered services to the debtor do not violate 11 U.S.C. § 524(e) because they do not affect liability of another entity on a debt of the debtor. Rather, the protections are consistent with the limited immunity granted to committees and professionals who serve the debtors. *See, e.g., Pan Am Corp. v. Delta Air Lines, Inc.*, 175 B.R. 438, 5114 (S.D.N.Y. 1994); *In re L.F. Rothschild Holdings, Inc.*, 163 B.R. 45, 49 (S.D.N.Y. 1994); *In re Drexel Burnham Lambert Group, Inc.*, 138 B.R. 717, 722 (Bankr. S.D.N.Y. 1992), *aff'd*, 140 B.R. 347 (S.D.N.Y. 1992); *In re Tucker Freight Lines, Inc.*, 62 B.R. 213, 216, 218 (Bankr. W.D. Mich. 1986).

***J. Monarch Life Insurance Co. v. Ropes & Gray, 65 F.3d 973 (1st Cir. 1995).***

## i. Facts

In the context of a chapter 11 plan proposed for Monarch Capital by its creditors and former subsidiary, Monarch Life, the court enjoined, among other things:

"commencement or continuation of any action or proceeding arising from or related to a claim against [Monarch Capital] against or

affecting or [sic]any property of [Monarch Capital], or any direct or indirect transferee of any property of, or direct or indirect successor in interest to, any of the foregoing...”

After confirmation, Monarch Life sued Ropes & Gray for allegedly having represented simultaneously Monarch Life and Monarch Capital and having deliberately concealed from Monarch Life the ongoing use by Monarch Capital of Monarch Life's funds when there was no realistic prospect of repayment. The logic of the release of Ropes & Gray and others was that although they were not contributing to the funding of the plan, actions against them would lead to the impleader of other parties who were contributing to the plan and who would not contribute unless they were assured of no further exposure.

- ii. Holding. The confirmation order has collateral estoppel effect barring suits against Ropes & Gray. Its ambiguity could have been litigated at confirmation.

***K. Resorts International, Inc. v. Lowenschuss (In re Lowenschuss), 67 F.3d 1394 (9th Cir. 1995).***

Here, Resorts International first filed a claim against Lowenschuss, but then realized its claim was against the Lowenschuss pension plan for having wrongfully tendered stock to Resorts International. Accordingly, Resorts International requested leave to withdraw its claim without prejudice to reinstatement if the pension plan were ultimately consolidated with Lowenschuss' estate. The bankruptcy court, however, told Resorts International to litigate its claim or withdraw it with prejudice even though the chapter 11 plan included a global release releasing the pension plan from Resorts International's claims. When Resorts International asked the bankruptcy court what the outcome would be if the pension plan were later consolidated, the court responded: “That's just tough. That's tough.” 67 F.3d at 1400.

On appeal, the court ruled Resorts International should be allowed to withdraw its claim without prejudice and affirmed the district court's vacation of the global release.

***L. In re G-I Holdings Inc., 2009 U.S. Dist. LEXIS 108339 (D. N.J. and Bankr. N.J., November 12, 2009)***

In this confirmation decision confirming a chapter 11 plan over the objection of the Internal Revenue Service, the District Court and Bankruptcy Court ruled:

Even if this Court's order were to comprise an injunction barring the IRS from collecting against non-debtor affiliates, such an injunction is a proper exercise of authority granted to this Court by the Bankruptcy Code and the United States Supreme Court's decision in *Energy Resources*. As discussed above, [sections 105\(a\)](#) and [1123\(b\)\(6\) of the Bankruptcy Code](#)

provide this Court with authority to issue orders "necessary to the success of a reorganization plan," even when that authority is not specifically designated by the Bankruptcy Code. [Energy Resources, 495 U.S. at 549](#). Because the Debtors have demonstrated that is critical to the Debtors' reorganization efforts that the IRS not seek to collect more from BMCA or ISP than it is entitled to under the Plan and Tolling Agreement, the Court may appropriately issue an order to enjoin the [\*168] IRS from collecting those additional amounts from the non-debtor affiliates. See [In re Airadigm Communs., Inc., 519 F.3d at 657](#) (holding that "this 'residual authority' permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code"). Because the IRS is unimpaired under the Plan, and the facts demonstrate that the release of BMCA from additional tax liability (of which G-I would be indirectly liable pursuant to its obligation to indemnify BMCA under the Tax Sharing Agreement) is critical to a successful reorganization, the Court's approval of amended section 2.4 of the Plan satisfies "the hallmarks of permissible non-consensual releases--fairness, necessity to the reorganization, and specific factual findings to support these conclusions." [In re Continental Airlines, 203 F.3d at 214](#). Finally, any such injunction issued by this Court would only be provisional, as it would be dependent upon the satisfaction by the Debtors of their obligations to the IRS under the Plan.