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## BANKRUPTCY DECISION ON THE SUPREME COURT'S DECISION DESK IN 2024

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In 2023, the Supreme Court issued three bankruptcy decisions: *Bartenwerfer v. Buckley*, *MOAC Mall Holdings LLC v. Transform Holdco LLC*, and *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*,[1] and denied cert petitions in four other bankruptcy cases.[2] *Bartenwerfer* applied Bankruptcy Code section 523(a)(2) to reject the ability of a non-culpable debtor to discharge liability for her partner's fraud—an issue with narrow import to cases involving fraud debts owed by individual debtors (and only in very limited circumstances by corporate debtors).[3] *MOAC Mall* determined that Bankruptcy Code section 363(m) is not jurisdictional in nature, meaning only that it is subject to arguments of waiver and forfeiture, an issue that does not frequently arise in a typical bankruptcy sale.[4] *Coughlin* confirmed that the Bankruptcy Code unequivocally abrogates the sovereign immunity of all governments, including federally recognized Native American tribes, which is doctrinally a significant holding, but not one that arises in most bankruptcy cases. These decisions will not fundamentally alter any aspect of chapter 11 bankruptcy practice for the vast majority of bankruptcy practitioners.

2024 presents a different picture altogether. The bankruptcy community breathlessly awaits decisions from the Supreme

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Court's October 2023 sitting in three highly significant bankruptcy cases: *Harrington v. Purdue Pharma L.P.*, *Truck Insurance Exchange v. Kaiser Gypsum Company*, and *Office of the U.S. Trustee v. John Q. Hammons Fall 2006, LLC*.

## *Harrington v. Purdue Pharma L.P.*

Perhaps the most significant of the three is *Purdue Pharma*. Amidst this country's tragic opioid addiction epidemic, the Purdue bankruptcy case has attracted nationwide attention to the ability of bankruptcy courts to non-consensually release non-debtors from liability through a confirmed chapter 11 plan.[5] These non-consensual third-party releases have become a cornerstone of litigation management strategy in the mass tort context, including in chapter 11 cases such as *Boy Scouts of America*, *LTL Management* (the Johnson & Johnson affiliate case), and *Aearo Technologies* (the 3M Company affiliate case), the latter two of which were dismissed as bad faith filings before the courts ever reached the issue of non-consensual third-party releases.[6] In *Purdue Pharma*, the Second Circuit approved non-consensual releases for the Sackler family and related entities, who were themselves not debtors in bankruptcy, and the government appealed.[7]

The legality of non-consensual third-party releases and the way in which a creditor's "consent" to such a release must be manifested has long divided courts around the country.[8] Courts varyingly approach the issue as one of jurisdiction, constitutional power, or statutory authorization and many standards have developed under the case law.[9] A minority of courts hold that such releases are only appropriate in the asbestos context, in which section 524(g) expressly authorizes entry of an injunction protecting third parties from liability.[10] The majority of courts finds non-consensual third-party releases are not strictly limited to asbestos cases, but may be approved in other exceptional circumstances.[11] Legislation has even been introduced (but not passed) in Congress to limit the ability of bankruptcy courts to approve non-consensual third-party releases.[12]

In *Purdue*, the issue as framed by the Court is whether the Bankruptcy Code authorizes a court to approve, as part of a plan of reorganization under Chapter 11 of the Bankruptcy Code, a release that extinguishes claims held by nondebtors against nondebtor third parties, without the claimants' consent.[13] On December 4, 2023, the Court heard oral argument from the Deputy Solicitor General on behalf of the Office of the United States Trustee, counsel for the Purdue Pharma debtors, and counsel for the Official Committee of Unsecured Creditors in the case. Unsurprisingly, considering the way in which the Court phrased the issue and the analysis of the courts below, a large focus of oral argument was on the statutory basis for non-consensual third-party releases. Specifically, whether section 1123(b)(6)—which authorizes a plan to include "any other appropriate provision not inconsistent with the applicable provisions of this title"—authorizes the inclusion of non-consensual third-party releases in a chapter 11 plan.

The Court's ruling on this issue will have broad implications for chapter 11 practice, not only in the mass tort and abuse liability context, but also in any non-asbestos business chapter 11 case in which the debtor seeks to resolve the liability of non-debtor parties as part of its chapter 11 plan.

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If the Court limits the ability of bankruptcy courts to approve these releases in the absence of creditor consent, bankruptcy becomes a less powerful liability management tool. The result could be fewer bankruptcy cases, as debtors look to other strategies, or it could be more bankruptcy cases, as non-debtor affiliates who seek the benefit of a release are forced to file their own cases, rather than ride the coattails of the filing debtor. A reversal in *Purdue Pharma* could also fling into question the validity of confirmed plans of reorganization in other cases that relied on similar releases, which will engender equitable mootness arguments in return.[14] Reversal could also lead to rapid developments in the case law on the meaning of creditor consent, as debtors are forced to obtain consent to secure these coveted releases.

Affirmance, on the other hand, would signal to debtors that bankruptcy remains a viable liability management strategy and a powerful tool for compromising claims even against nondebtors. The implications of an affirmance could, however, be narrowed by the facts of *Purdue*—in that case, releases were granted to an identifiable group of non-debtors (the Sackler family and related entities) who contributed vast sums of money (up to $6 billion) to fund payments to creditors as part of the chapter 11 plan. In other cases, the releases sought have covered many more non-debtors who contributed far less.[15] The Court's ruling could also resolve open issues in the case law regarding the nature of the claims that can be covered by these releases, *i.e.*, whether direct claims may be released or only derivative claims, and how close a nexus there must be between the claims against the third-party and the debtor's own liability.

## *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc.*

The *Truck Insurance* case considers the prudential bankruptcy doctrine of "insurance neutrality." The issue as presented to the Court is whether an insurer with financial responsibility for a bankruptcy claim is a "party in interest" that may object to a plan of reorganization under chapter 11 of the Bankruptcy Code.[16] The insurance neutrality doctrine prohibits an insurance company from challenging a bankruptcy plan as a party in interest within the meaning of Bankruptcy Code section 1109 when the plan does not alter the insurer's quantum of liability under the applicable prepetition insurance contracts.[17] The case makes an interesting companion case to *Purdue Pharma* because the ability to forestall an objecting insurance company's opposition to a chapter 11 plan by drafting the plan as "insurance neutral" is a key strategic objective for mass tort debtors who frequently rely on insurance coverage to fund payments to creditors.[18]

Plan proponents tend to view a chapter 11 plan as insurance neutral when the bankruptcy court is not being asked to make coverage determinations and insurance issues are preserved to be determined in separate coverage litigation in a court of competent jurisdiction (typically a state court). Insurers argue, by contrast, that the filing of the bankruptcy case, the cooperation of the debtor-insured with claimants, the channeling of claims to a settlement trust, and the resolution of claims through administrative trust procedures, all fundamentally alter the insurer's rights. The objecting insurer in *Truck Insurance* sought to object to the debtors' chapter 11 plan on the basis that it failed to include anti-fraud provisions in the claims determination process only with respect to claims that would be presented to the insurance company for payment.

The case involves a circuit split as to the meaning of section 1109(b), which provides that any "party in interest" may raise and be heard on any issue in a chapter 11 case. The Third Circuit construes the provision as allowing a party to participate as a party in interest whenever the party satisfies Article III standing by showing a cognizable, traceable, and redressable stake in the resolution of the matter, whereas the Fourth and Seventh Circuits construe section 1109(b) as imposing certain additional constraints on party in interest standing beyond those of Article III.[19]

On March 19, 2024, the Court heard oral argument from counsel for Truck Insurance, the Assistant Solicitor General on depart of the United

States Department of Justice as amicus curiae, counsel for the Kaiser Gypsum debtors, and counsel for respondent claimants. From the justices' questioning, it seems that the Court will find the insurance company here had standing to object to the chapter 11 plan as a party in interest. If the Court so finds, a plan proponent's task in crafting an "insurance neutral" chapter 11 plan will be much harder going forward, meaning that insurance companies will have more negotiating leverage in the plan process.

### *Office of the United States Trustee v. Jonn Q. Hammons Fall 2006, LLC*

*Hammons* is a companion case to an earlier Supreme Court decision, *Siegel v. Fitzgerald*. In *Siegel*, the Court determined that a statutory amendment that imposed a temporary increase in the quarterly fees payable by debtors in bankruptcy cases in certain judicial districts in which the United States Trustee system is in place (but not in other districts that rely on a parallel bankruptcy administrator system)[20] was unconstitutional as a violation of the uniformity requirement of the Bankruptcy Clause of the United States Constitution.[21] The Court stopped short in *Siegel* of identifying what the remedy for that Constitutional violation should be. Following *Siegel*, certain representatives of bankruptcy estates in the 48 United States Trustee program states filed lawsuits seeking refunds of the incremental amounts paid by those estates for quarterly United States Trustee fees in excess of the amounts that would have been paid absent the unconstitutional statutory amendment. John Q. Hammons Fall 2006, LLC filed such a suit against the United States Trustee and the Tenth Circuit found the estate was entitled to a refund for the overpayments relative to estates in bankruptcy administrator districts.[22]

The Court granted the petition for writ of certiorari in *Hammons* to determine the appropriate remedy for the Constitutional violation identified in *Siegel* in the face of diverging case law across the country. The issue as presented to the Court is whether the appropriate remedy is to require the Office of the United States Trustee to grant retrospective refunds of the increased fees paid by debtors in the United States Trustee districts during the period of disuniformity or to require the collection of additional fees from the affected debtors in bankruptcy administrator districts.[23] That framing of the issue leaves out the third possibility, that the remedy for the Constitutional violation identified in *Siegel* should be prospective only, meaning no refunds and no additional payments, but rather mandatorily parallel fees across all districts (which is now the state of the law).[24] On January 9, 2024, the Court heard oral argument from the Assistant Solicitor General on behalf of the Office of the United States Trustee and counsel to the debtor.

This issue affects a significant number of estates. For perspective, the 2018 fee increase raised the maximum fee from $30,000 per quarter to $250,000 per quarter. The estate in *Hammons* seeks a refund of approximately $2.5 million as a result of the non-uniform implementation of that fee increase. The government asserts that approximately $326 million in potential refunds of quarterly United States Trustee fees could be at issue in the aggregate.[25] If the Court requires refunds, the government argues that money will come from American taxpayers at the expense of other government programs. The refunds, net of professional fees, would then be distributable for the benefit of creditors. On the other hand, requiring estates in bankruptcy administrator districts to pay additional fees on account of the non-uniform period presents obvious practical obstacles—many of these cases have been long closed and no entity may presently exist to make such payments. Leaving the Constitutional violation unremedied for the non-uniform period is certainly an unsatisfactory result, but practically the easiest one to implement.

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Decisions from the Court in *Purdue Pharma*, *Truck Insurance*, and *Hammons* are expected this summer. However the Court rules on these issues, it will be impactful. Check back here for further analysis and insights following the issuance of the Court's opinions.

**ENDNOTES:**

[1]*Bartenwerfer v. Buckley*, 143 S. Ct. 665 (2023); *MOAC Mall Holdings LLC v. Transform Holdco LLC*, 143 S. Ct. 927 (2023); *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*, 143 S. Ct. 1689 (2023).

[2]*Cuker Interactive, LLC v. Pillsbury Winthrop Shaw Pittman, LLP*, 143 S. Ct. 1054 (2023); *Fin. Oversight and Mgmt. Bd. for Puerto Rico v. Cooperative de Ahorro y Credito Abraham Rosa*, 143 S. Ct. 774 (2023); *Buckner v. U.S. Pipe & Foundry Co.*, 143 S. Ct. 2657 (2023); *Spring Valley Produce, Inc. v. Forrest*, 143 S. Ct. 2579 (2023).

[3]Section 523(a)(2) makes debts for money, property, services, or an extension, renewal, or refinancing of credit non-dischargeable in individual cases to the extent obtained by false pretenses, a false representation, actual fraud, and the like. The provision is made applicable to render those same debts non-dischargeable in a corporate debtor's bankruptcy case by section 1141(d)(6), but only to the extent the debt is owed to a domestic governmental unit or to a person as a result of claim asserted against the United States Government.

[4]Cited in effectively every sale order, Bankruptcy Code section 363(m) validates most bankruptcy court sale and lease orders notwithstanding reversal or modification on appeal, in absence of a stay.

[5]Film and television content spotlighting the opioid crisis and the Sackler family's attempt to cut off its liabilities related thereto have also fanned the flames of attention on this issue.

[6]*In re LTL Mgmt., LLC*, 652 B.R. 433 (Bankr. D.N.J. 2023); *In re Aearo Techs. LLC*, 2023 WL 3938436 (Bankr. S.D. Ind. June 9, 2023).

[7]*Purdue Pharma L.P. v. City of Grande Prairie (In re Purdue Pharma L.P.)*, 69 F.4th 45, 71-75 (2d Cir. 2023), cert. granted, 144 S. Ct. 44, 216 L. Ed. 2d 1300 (2023).

[8]*Cf. In re Zenith Elecs. Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999) (voting in favor of a chapter 11 plan constitutes consent to a third-party release contained therein); *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 507 (Bankr. D.N.J. 1997) (consent to a third-party release must be "unambiguously manifested" and cannot be inferred from an affirmative plan vote or a failure to object); *In re Calpine Corp.*, 2007 WL 4565223 (Bankr. S.D.N.Y. Dec. 19, 2007) (a third-party release is consensual if the creditor abstains from voting on the chapter 11 plan and elects not to opt out of a conspicuously noticed release). Even courts within a single district are divided on this issue. *Cf. In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013) (creditors who abstain from voting on the plan and fail to opt out of a release consent); *In re Wash. Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011) (requiring affirmative consent by voting in favor of the plan and not opting out of the release).

[9]*See, e.g.*, *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 137-40 (3d Cir. 2019) (bankruptcy court had constitutional authority to approve non-consensual third-party releases); *Purdue Pharma L.P. v. City of Grande Prairie (In re Purdue Pharma L.P.)*, 69 F.4th 45, 71-75 (2d Cir. 2023) (bankruptcy court had subject-matter jurisdiction and statutory authority to approve non-consensual third-party releases).

[10]*Bank of NY Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009); *Abel v. West,* 932 F.2d 898 (10th Cir. 1991) (non-consensual third-party releases are not permitted because section 524(e) prohibits the discharge of non-debtors and because Congress provided explicit authority for the release of third parties only in the asbestos context pursuant to section 524(g)).

[11]*See, e.g.*, *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142-43 (2d Cir. 2005) (non-consensual third-party releases are appropriate in unusual circumstances where the released parties may substantial financial contributions, the enjoined claims are channeled rather than extinguished, the enjoined claims impact the debtor's reorganization by way of indemnity or contribution, and the plan provides for payment in full of the enjoined claims); *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 213-14 (3d Cir. 2000) (the hallmarks of a permissible non-consensual third-party release is fairness, necessity to the reorganization, and specific factual findings supporting these conclusions); *Menard-Sanford v. Mabey (In re A.H. Robins Co., Inc.)*, 880 F.2d 694, 702 (4th Cir. 1989) (non-consensual third-party releases are appropriate where the plan is overwhelmingly supported by creditors, provides for payment in full of creditors' claims, the release was essential to the reorganization, and the released parties made substantial contributions); *Class Five Nevada Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002) (non-consensual third-party releases are appropriate in "unusual circumstances" where there is an identity of interest between the debtor and the third party, the third party has made substantial contributions, the release is essential to the reorganization, the impacted class overwhelmingly voted to accept the plan, the plan provides a mechanism to pay substantially all the affected claims, the plan provides an opportunity for those claimants who choose not to settle to recover in full, and specific factual findings support these conclusions); *In re*

*Airadigm Communications, Inc.*, 519 F.3d 640, 657 (7th Cir. 2008) (non-consensual third-party release appropriate where narrowly tailored to cover only claims arising out of or in connection with the reorganization and to exclude willful misconduct, the third party required the release, and the third parties involvement was essential); *SE Property Holdings, LLC v. Seaside Engineering & Surveying, Inc. (In re Seaside Engineering & Surveying, Inc.)*, 780 F.3d 1070, 1075-81 (11th Cir. 2015) (adopting the Sixth Circuit's standard from *Dow Corning*).

[12]The Nondebtor Release Prohibition Act of 2021, H.R. 4777, S. 2497.

[13]*Harrington v. Purdue Pharma L.P.*, No. 23-124 (Aug. 10, 2023). The Solicitor General filed an application for a stay of the mandate of Second Circuit pending the filing and disposition of a petition for a writ of certiorari. The Supreme Court granted the stay and elected to treat the application as a petition for writ of certiorari, which gave the Court (rather than the petitioner) the opportunity to phrase the issue presented in the first instance.

[14]The case of *Highland Capital Mgmt., L.P. v. NextPoint Advisors, L.P.* has been held in abeyance by the Court pending a decision in *Purdue Pharma* and is likely to be remanded for further proceedings consistent with whatever decision the Court reaches in *Purdue*.

[15]*See, e.g.*, *In re Boy Scouts of America*, No. 22-1237, Dkt. No. 150 (D. Del. Mar. 28, 2023) (affirming bankruptcy court decision confirming chapter 11 of plan, including non-consensual releases of thousands of non-debtors, that vast majority of which made no cash contribution to funding creditor claims). Objecting creditors have appealed the District Court's affirmance of the confirmation order and sought a stay pending appeal from the Supreme Court, which the Court denied. *Lujan Claimants v. Boy Scouts of America*, No. 23A741 (Feb. 22, 2024).

[16]*Truck Insurance Exchange v. Kaiser Gypsum Co., Inc.*, No. 22-1079, *Petition for Writ of Certiorari* (May 3, 2023).

[17]*See, e.g.*, *In re Global Indus. Techs.*, 645 F.3d 201, 212 (3d Cir. 2011).

[18]A notable distinction from Purdue is that Kaiser Gypsum is an asbestos company and was thus able to invoke the particular provisions of section 524(g) to protect non-debtors from liability.

[19]*Cf. In re Global Industrial Technologies, Inc.*, 645 F.3d 201, 211 (3d Cir. 2011) (en banc) (section 1109(b) and Article III are "effectively coextensive"), *In re C.P. Hall Co.*, 750 F.3d 659, 662-63 (7th Cir. 2014) (reaffirming prudential limitations on standing after acknowledging potential "split" with other circuits), *Truck Insurance Exchange v. Kaiser Gypsum Co., Inc. (In re Kaiser Gypsum Co., Inc.)*, 60 F.4th 73 (4th Cir. 2023) (requiring insurer to show in addition that the plan increases the insurer's obligations or impairs the insurer's policy rights).

[20]The increased fees were payable in the majority of judicial districts, which have adopted the United States Trustee program. Judicial districts in North Carolina and Alabama instead rely on judicially appointed bankruptcy administrators to perform the functions undertaken by the United States Trustees in the other states. Although the functions of the trustees and the administrators are equivalent, the two programs are separately funded. The trustee program is funded by quarterly fees paid by bankruptcy estates pursuant to 28 U.S.C.A. § 1930(a)(6) that are deposited into the U.S. Treasury and calculated based on disbursements in the bankruptcy. The administrator program is funded by the Judiciary's budget and comparable fees were typically (though not mandatorily) assessed in cases in those districts. The increase in quarterly trustee fees went into effect in trustee program districts in the first quarter of 2018 and applied to all cases then pending in such districts and in all cases filed thereafter. A comparable increase in fees was not implemented in administrator districts until October 2018, and the increase in those districts applied only to newly filed cases and not to then-pending cases.

[21]*Siegel v. Fitzgerald*, 596 U.S. 464 (2022).

[22]*In re John Q. Hammons Fall 2006, LLC*, 2022 WL 3354682 (10th Cir. 2022).

[23]*Office of the United States Trustee v. John Q. Hammons Fall 2006, LLC*, No. 22-1238, *Petition for a Writ of Certiorari* (June 23, 2023).

[24]In 2021, Congress amended the relevant statute governing the payment of fees in administrator program districts to provide that fees charged such districts shall (rather than may) be the same as those charged in the trustee program districts. 28 U.S.C.A. § 1930(a)(7).

[25]*Office of the United States Trustee v. John Q. Hammons Fall 2006, LLC*, No. 22-1238, *Petition for a Writ of Certiorari* (June 23, 2023).

 