

**THIRD-PARTY RELEASES UNDER THE BANKRUPTCY CODE AFTER
*PURDUE PHARMA***

JEANNE L. SCHROEDER* & DAVID GRAY CARLSON**

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* Professor of Law, Benjamin N. Cardozo School of Law.

** Professor of Law, Benjamin N. Cardozo School of Law. Special thanks to Professor Ralph Brubaker for comments on an earlier draft of this article.

INTRODUCTION

The largest chapter 11 case ever, as measured by creditor claims (\$140 trillion), is *In re Purdue Pharma*,¹ where Bankruptcy Judge Robert Drain confirmed a plan that, in exchange for a payment of \$4.325 billion, released the equity owners (the Sackler family) and other insiders from liability for the prodigious sins of the debtor Purdue Pharma, manufacturer of OxyContin (an opioid). The confirmation order sanctifying this settlement was reversed on appeal to District Court Judge Colleen McMahon because the third-party nondebtor releases, though jurisdictionally possible, are nevertheless not authorized by the Bankruptcy Code. Since that reversal, the Sacklers settled with many of the outstanding objectors (state governments and the District of Columbia) by agreeing to pay more than a billion dollars extra toward funding opiate abatement and victim compensation.² The appeal is nevertheless proceeding apace, as the Department of Justice still opposes the appeal by the debtor-in-possession to the Second Circuit Court of Appeals.

The case addresses a fundamental unresolved issue for bankruptcy law. May a bankruptcy court confirm a plan that releases nondebtor third parties from liability to individual creditors?

In this Article, we analyze the *Purdue plan* as confirmed by Judge Drain. Our judgment is that the *Purdue plan* was indeed confirmable on its face, but that Judge Drain's interpretation of the plan's effect exceeded its literal meaning.

The plan releases the Sacklers from "derivative" claims. But what does it mean for a creditor's claim against a third party to be derivative? Properly defined, a creditor's derivative claim belongs to the debtor-in-possession alone. Only the debtor-in-possession can settle it. If the debtor-in-possession settles such a claim, the unsecured creditors are bound, since the debtor-in-possession represents the unsecured creditors. The third-party defendants who settle (here, the Sackler family) pay their obligation once and for all. *Res judicata* protects the third-party settlers. They may not be sued again. If a "channeling injunction" is issued to prevent individual creditors from suing the settlers, this merely expresses the doctrine of *res judicata*. The purpose of the channeling injunction is for the bankruptcy court to control the *res judicata* issue. But for the channeling injunction, an individual creditor (C_1) could bring a fraudulent transfer action in state court somewhere. The state court should properly bar the action on *res judicata* grounds. Suppose it errs and permits C_1 to bring suit. Then the third-party settlor (AD , for "account debtor")

¹ 633 B.R. 53, 84 (Bankr. S.D.N.Y. 2021), *rev'd*, 635 B.R. 26 (S.D.N.Y. 2021); see Paul R. Hage, "The Great Unsettled Question": *Nonconsensual Third-Party Releases Deemed Impermissible in Purdue*, 21 AM. BANKR. INST. J., Feb. 2022 at 12, 45 ("It is not an exaggeration to say that Judge McMahon's opinion is one of the most consequential bankruptcy opinions of our time."). See *In re Purdue Pharma*, 635 B.R. at 62 ("Just 10% of the claims so filed would give rise to over \$140 trillion in aggregate liability — more than the whole world's gross domestic product.").

² See Mediators' Fourth Interim Report Case at 4; *In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021) (No. 19-23649 (RDD)); see Jonathan Randles, *Justice Department Appeal Threatens \$6 Billion Sackler Opioid Settlement*, WALL ST. J., (Mar. 21, 2020), <https://www.wsj.com/articles/justice-department-appeal-threatens-6-billion-sackler-opioid-settlement-11647886850?page=1>.

is at the mercy of the state courts. If the supreme court of the state wrongly finds no *res judicata*, *AD* is dependent on the United States Supreme Court,³ which is no doubt too busy to supervise the *res judicata* effect of every chapter 11 plan. Where, however, there is a channeling injunction, *AD* can return to the bankruptcy court and seek an order forcing *C₁* to drop the state court action on *res judicata* grounds.⁴ The channeling injunction is nothing but an instance of the bankruptcy court retaining jurisdiction over disputes as to the meaning of a chapter 11 plan.⁵

Derivative claims belong to the debtor-in-possession alone. Individual unsecured creditors have no property interest in them. But this was not how Judge Drain interpreted the phrase “derivative claim.” He took “derivative claim” to mean any claim against the Sacklers that could also have been brought against Purdue Pharma. Thus, if they were jointly and severally liable as tortfeasors with Purdue Pharma, the Sacklers were released from tort or statutory actions that might have been brought directly by or on behalf of injured victims of OxyContin. Such causes of action belong to the individual creditors, not to the debtor-in-possession. A channeling injunction prohibiting suits against the Sacklers for tortious acts they committed constitutes an expropriation of property owned by individual creditors.⁶ The plan was not confirmable if it meant what Judge Drain thought it meant and what the Sacklers hoped it meant.⁷ Judge McMahon accepted this interpretation of the plan:

[T]he Plan provides broad releases, not just of derivative, but of particularized or direct claims — including claims predicated on fraud, misrepresentation, and willful misconduct under various state consumer protection statutes — to the members of the Sackler family (none of whom is a debtor in the bankruptcy case) and to their affiliates and related entities. . . . The great unsettled question in this case is whether the Bankruptcy Court — or any court — is

³ See, e.g., *Van Huffel v. Harkelrode*, 284 U.S. 225, 226 (1931).

⁴ *Tronox Inc. v. Kerr McGee Corp. (In re Tronox Inc.)*, 855 F.3d 84, 102 (2d Cir. 2017).

⁵ See *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 151 (“[T]he Bankruptcy Court plainly had jurisdiction to interpret and enforce its own prior orders.”); see also *Local Loan Co. v. Hunt*, 292 U.S. 234, 239 (1934) (“That a federal court of equity has jurisdiction of a bill ancillary to an original case or proceeding in the same court . . . to secure or preserve the fruits and advantages of a judgment or decree rendered therein, is well settled.”).

⁶ *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 807 (1985) (“[A] chose in action is a constitutionally recognized property interest possessed by each of the plaintiffs.”).

⁷ See *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 983 (1st Cir. 1995).

Even though our interpretation of the confirmation order essentially presents a question of law, . . . the bankruptcy court in this case was interpreting its own order of confirmation. We think customary [] deference is appropriate in these circumstances with respect to the bankruptcy court’s determination that the confirmation order was sufficiently broad to confer “incidental” protection to noncontributing parties like [attorneys to the chapter 11 debtor].

Id.

statutorily authorized to grant such releases.⁸

Judge McMahon would go on to rule that the Bankruptcy Code did not authorize the releases in *Purdue*.⁹ But the plan as written bars derivative claims only. If we adhere to the classic meaning of “derivative claim,” the plan could have been confirmed. And the Sacklers could be sued by those creditors who did not support the plan.

A great many category mistakes have been made in the judicial opinions adjudicating the *Purdue* chapter 11 plan. The case entails a “channeling injunction” protecting the Sackler family and others from claims derivative of the rights of Purdue Pharma. In her opinion reversing Judge Drain, Judge McMahon refers to channeling injunctions as third-party releases — supposedly not authorized by the Bankruptcy Code except in asbestos mass tort cases.¹⁰ In fact, there are many types of channeling injunctions. Many of these are indeed implicitly authorized by the Bankruptcy Code — inside and outside the context of asbestos mass torts. There is only one type of injunction that properly can be considered illegitimate straight out — an injunction that, without compensation in full, bars individual creditors from suing third-party tortfeasors. Such an injunction expropriates property of non-debtor third parties in exchange for contributions to the chapter 11 plan by the released third parties. When these contributions fail to pay the third-party claimants in full, these releases are not authorized.¹¹ We shall nickname these plan provisions as “theft” — the bankruptcy estate is robbing third parties of their choses in action against non-debtor defendants in exchange for a cash payment from the defendants to the debtor-in-possession.

Where injunctions do not institute a theft, they are often authorized by the Bankruptcy Code. If we measure legitimacy on a sliding scale, at the beginning of the scale are channeling injunctions connected with the settlement of derivative claims. At the end of the scale are theft plans. Right in the middle are theft-plus-compensation plans — what we shall call “eminent domain” plans. In such plans, particularized creditor rights are taken, but the creditors are *paid in full*. Many courts believe eminent domain plans may be confirmed. But, as *Purdue* falls well short of full compensation of third parties (by trillions of dollars), such plans we may leave as possible but controversial. To judge the *Purdue plan*, we withhold judgment on whether eminent domain plans can be confirmed and examine whether the *Purdue plan* accomplishes uncompensated theft.

⁸ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 36–37 (S.D.N.Y. 2021).

⁹ *See id.* at 38.

¹⁰ *See id.* at 37, 67, 89–90 (Judge McMahon concluding that “the sections of the Code on which the learned Bankruptcy Judge [Drain] explicitly relied . . . do not confer on any court the power to approve the release of non-derivative third-party claims against non-debtors . . .”).

¹¹ *See In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 723 (Bankr. S.D.N.Y. 2019) (“As a general rule, a bankruptcy court has no power to say what happens to property that belongs to a third party, even if that third party is a creditor . . .”). Judge Wiles’s opinion in *Aegean Marine* is a valuable primer on what is and is not authorized by the Bankruptcy Code.

This Article is divided into four parts. Part I presents a taxonomy of third-party releases — most of which are consistent with the terms of the Bankruptcy Code. Theft plans are not confirmable. Eminent domain plans are controversial.

Part II examines the *Purdue plan*. Since it purports to release derivative claims, it is not a theft plan at all, and so it may be confirmed. But Judge Drain's interpretation of the plan departs from the concept of "derivative claim." He interpreted the plan to be a theft plan and found it to be confirmable.

Part III examines Judge McMahon's opinion reversing the confirmation order. It is remarkable that Judge McMahon could generate a 250-page opinion in the course of two months. In comparison it took your present authors three months to *read* the opinion. Upon investing that effort, we find the opinion to be largely correct, but encumbered by some mistakes, which we analyze in Part III.

Part IV considers whether court jurisdiction has any role to play in the analysis of third-party releases. Both Judges Drain and McMahon concluded that jurisdiction existed to confirm the plan. We will disagree with the details of their jurisdictional analysis, but in the end we agree that court jurisdiction has no role to play in analyzing the confirmability of third-party releases. The only question is whether the Bankruptcy Code authorizes them. If it does, there is jurisdiction to confirm the plan. If it does not, the plan ought not to be confirmed. If the plan is erroneously confirmed, it is nevertheless binding on the creditors, unless confirmation is reversed on appeal. Jurisdiction falls entirely out of the equation when appellate courts review confirmation of a chapter 11 plan.¹²

I. SPECIES OF RELEASES

There are many kinds of third-party releases. Many are well-grounded in the Bankruptcy Code. Thus, Judge McMahon overstepped the form of plausible manner when she declared that, in the Second Circuit, "the only fair characterization of the law on the subject of statutory authority to release and enjoin the prosecution of third party claims against non-debtors in a bankruptcy case is: unsettled, except in asbestos cases, where statutory authority is clear."¹³ In fact, there are many circumstances where channeling injunctions legitimately protect non-debtors from suits by non-debtors.

¹² Cf. Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. ILL. L. REV. 765, 772–73 (2015) ("The unbroken line of case authority throughout the nineteenth century and up to and even into the Great Depression on the scope of the Bankruptcy Clause [of the Constitution] all proceeded on the universally shared assumption that the scope of the bankruptcy power was to be divined only by reference to the parameters of the Bankruptcy Clause itself.").

¹³ *In re Purdue Pharma*, 635 B.R. at 104.

A. Settlements

In chapter 11, everyone hopes for settlement.¹⁴ Federal Rule of Bankruptcy Procedure 9019¹⁵ requires court approval of any settlement of a claim that a bankruptcy trustee (*T*) has against a third-party (whom we shall call *AD*, for account debtor,¹⁶ or debtor of a debtor). As the court in *In re Aegean Marine Petroleum Network, Inc.*¹⁷ said:

It is often the case that a Bankruptcy Court is asked to enforce a debtor's own releases by issuing an injunction that prevents third parties from asserting claims that belonged to the estate and that were released by the debtor. . . . These are sometimes described as third-party releases or as injunctions against third-party claims, but that is not really an accurate characterization of what they are. Injunctions of this kind are more properly described as injunctions against interference with a debtor's court-approved decisions about the disposition of claims that belonged to the debtor.¹⁸

Where *T* succeeds to a cause of action owned by the debtor (whom we shall call *D Corp.*), *T* represents the creditors in what is effectively a mandatory non-opt-out class action. When *T* chooses to settle, *T* is subject to rigorous fairness scrutiny by a court¹⁹ (just as in a class action).²⁰ If the court finds the settlement is fair, the unsecured creditors (whom we will refer to as the *C_g*) are absolutely bound. The *C_g* have standing to object to the settlement, and the bankruptcy court will carefully listen to their objections. But if the court approves the settlement as fair, the chose in action that *AD* owes to *T* is extinguished when paid. *AD* cannot be sued again under principles of *res judicata*.

Bankruptcy Code section 105(a) provides that a bankruptcy court “may issue any order . . . that is necessary or appropriate to carry out the provisions of this title.”²¹ It is well agreed that, rather than suffering *AD* to plead *res judicata* in state and federal courts around the nation, a bankruptcy court, in a channeling injunction,

¹⁴ See Protective Comm. for Indep. S'holders of TMT Trailer Ferry v. Anderson, 390 U.S. 414, 424 (1968) (“In administering reorganization proceedings in an economical and practical manner it will often be wise to arrange the settlement of claims as to which there are substantial and reasonable doubts.”); Motorola, Inc. v. Off. Comm. of Unsecured Creditors (*In re Iridium Operating LLC*), 478 F.3d 452, 455 (2d Cir. 2007) (finding “little doubt” of this).

¹⁵ FED. R. BANKR. P. 9019(a).

¹⁶ U.C.C. § 9-102(a)(3) (“‘Account debtor’ means a person obligated on . . . [a] general intangible.”).

¹⁷ *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 720 (Bankr. S.D.N.Y. 2019).

¹⁸ *Id.*

¹⁹ FED. R. BANKR. P. 9019(b).

²⁰ See FED. R. CIV. P. 23(e)(2).

²¹ On the history of section 105(a), see Daniel B. Bogart, *Resisting the Expansion of Bankruptcy Court Power Under Section 105 of the Bankruptcy Code: The All Writs Act and an Admonition from Chief Justice Marshall*, 35 ARIZ. ST. L.J. 793, 794 (2003).

may enjoin suits precluded by *res judicata*. If *AD* should be wrongly sued in some other court, *AD* can return to the bankruptcy court and bring contempt proceedings against the offending $C_l \subset C_g$ for violating the channeling injunction.²²

1. Breach of Fiduciary Duty

Prior to its bankruptcy petition, *D Corp.* may own a cause of action against *AD*. Unless *D Corp.* has granted a security interest in it or unless a judgment creditor has garnished *AD*, causes of action are solely *D Corp.*'s property. No C_l has any property in the chose in action.

In bankruptcy, *T* inherits *D Corp.*'s choses in action against *AD*.²³ These choses in action may include actions against *D Corp.*'s officers and directors for breach of fiduciary duty. As to these causes of action, only *T* may assert them.²⁴ Only *T* may settle them. The settlement agreement is binding on all the C_g whom *T* represents.

In the case of breaches of fiduciary duty, it is usually held that *D Corp.*'s officers and directors owe this duty directly to *D Corp.* and not to the C_g of *D Corp.* That is, *D Corp.* owns the chose in action against the *AD* and the C_g do not. In *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*,²⁵ the Delaware Supreme Court clarified this expressly by denying that officers and directors owe a fiduciary duty directly to creditors but confirming that once a corporation has entered the zone of insolvency, creditors may be able to bring a derivative action in the corporation's name, just as the stockholders might. Of course, as the adjective implies, this action is merely *derivative* of the corporation's rights. The board of directors always has the power to wrest back control over the action.²⁶ In bankruptcy, *T* inherits this claim.

Outside of bankruptcy, a given C_l with a judgment against *D Corp.* may obtain a judicial lien against *D Corp.* property. Where *AD* has breached a fiduciary duty to *D Corp.*, C_l may garnish *AD* and force *AD* to pay the sheriff instead of paying *D Corp.* C_l 's right against *AD* in this case is commonly said to be "derivative." That is to say, C_l does not own a chose in action against *AD*. C_l owns a chose in action against *D Corp.* In connection with its right against *D Corp.*, C_l , in a garnishment proceeding, can step into *D Corp.*'s shoes and enforce *D Corp.*'s right against *AD*. C_l "derives" its right from *D Corp.* and has no direct right of its own.

²² C_l stands for a creditor who has emerged from the C_g to claim a specific right to sue.

²³ 11 U.S.C. § 541(a)(1) (2018).

²⁴ See FED. R. BANKR. P. 6007 (providing *T* may prosecute any action on behalf of the estate in any tribunal without court approval).

²⁵ 930 A.2d 92, 103 (Del. 2007).

²⁶ Since the individual directors will either have conflicts of interest (if they are named defendants) or sympathy for their fellow directors or officers, the courts have developed procedural and substantive protections for settlement of derivative actions usually involving the appointment of a special litigation committee consisting of disinterested directors. The seminal case establishing this is *Zapata Corp. v. Maldonado*, 430 A.2d 779, 786 (Del. 1981) (finding "the interest taint of the board majority is per se a legal bar to the delegation of the board's power to an independent committee composed of disinterested board members").

Bankruptcy engenders a powerful automatic stay,²⁷ which prohibits C_l from controlling $D Corp.$ property. Once $D Corp.$ is in bankruptcy, $D Corp.$'s bankruptcy trustee has sole right to use, sell or lease property of the bankruptcy estate. The attempt to garnish AD constitutes "using" $D Corp.$'s chose in action. When it comes to choses in action, collection is "use and enjoyment."

Thus, when T sues AD for breach of a fiduciary duty owed to $D Corp.$, only T may "use" this chose in action. Hopefully, T persuades AD to settle and pay. Once settlement occurs and the bankruptcy court has found the settlement to be fair, AD 's debt is satisfied. It ceases to exist. Under such circumstances, the Supreme Court has backhandedly indicated that an injunction appropriately protects AD from any further suit by C_l .²⁸

After bankruptcy, if C_l attempts to garnish AD 's obligation to $D Corp.$ and to make AD pay C_l 's claim against $D Corp.$, AD 's defense is that AD 's debt to $D Corp.$ no longer exists because AD paid it. The garnishable debt has disappeared, and C_l has no basis to compel AD to pay. A third-party release that forbids C_l from suing AD simply repeats this premise.²⁹

2. Piercing Corporate Veils

A hazy idea in nonbankruptcy law is "piercing the corporate veil." Normally a corporation and its stockholders are considered separate persons so that neither is liable for the debts of the other and the judgment creditors of one cannot attach the property of the other. Suppose, however, that $D Corp.$ is 100% owned by a shareholder (SH). SH does not honor the separate personhood of $D Corp.$ For example, she does not respect corporate formalities and treats $D Corp.$ as her personal bank account, writing checks on $D Corp.$'s deposit account for SH 's personal expenses, etc. Suppose $D Corp.$ breaches a contract with, or commits a tort against, C_l . C_l brings suit against SH on the grounds that a court, as a matter of equity, should "pierce the corporate veil." In other words, the court should treat SH and $D Corp.$ as though they were the same legal person. Therefore, $D Corp.$'s act are SH 's acts. C_l can therefore have judgment against SH and may thereafter levy on SH 's assets.³⁰

Confusion has been generated when courts characterize piercing as a cause of action against SH that belongs either to C_l to T . This is a category mistake.³¹

²⁷ See 11 U.S.C. § 362(a).

²⁸ In *Travelers Indemnity Co. v. Bailey*, 557 U.S. 137 (2009), the Supreme Court announced that it did "not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against insurers that are not derivative of the debtor's wrongdoing." *Bailey*, 557 U.S. at 155. The implication is that an injunction can legitimately protect an AD who settles a "derivative" claim against AD owned by $D Corp.$

²⁹ See *Munford v. Munford (In re Munford, Inc.)*, 97 F.3d 449, 455 (11th Cir. 1996).

³⁰ A closely related concept is so-called "reverse piercing" when a creditor of SH attempts to attach the assets of $D Corp.$ For simplicity, we will refer to "piercing," but our discussion equally applies to reverse piercing.

³¹ See Jeanne L. Schroeder & David Gray Carlson, *Generalized Creditors and Particularized Creditors: Against A Unified Theory of Standing in Bankruptcy*, 96 AM. BANKR. L.J. 505, 510 (2022).

Piercing is not itself a cause of action.³² *C_I* has a cause of action for breach of contract or tort against *D Corp.* Piercing declares that *D Corp.* and *SH* are the same person with respect to a cause of action — *i.e.* it is the conclusion that the assets of *SH* are the assets of *D Corp.* and *vice versa*. Therefore, when *D Corp.* files for bankruptcy, *SH* is, in effect, also the debtor in the bankruptcy. They are the same person. *SH*'s property is property of the bankruptcy estate. Bankruptcy's automatic stay protects property of the bankruptcy estate from *C_I*'s lawsuit. *C_I* may not sue *SH* in state court because *SH* (*i.e.*, *D Corp.*'s alter ego)³³ is the debtor in *D Corp.*'s bankruptcy.

As we note elsewhere,³⁴ piercing is one of the most contentious and litigated areas in corporate law. We do not pretend to discuss the substantive grounds for piercing. We merely note, as many others have before us,³⁵ the terminology of piercing is often loosely and lazily thrown around by courts when the real concern is that *SH* has received fraudulent transfers from *D Corp.* or *SH* has otherwise defrauded *C_I* but it is difficult for *C_I* to establish all of the elements of the fraud. We call this “false piercing.” False piercing exists when it is clear that *D Corp.* and *SH* are in fact different persons.

For example, in *Board of Trustees v. Foodtown, Inc.*,³⁶ *D Corp.* was 100% owned by *P Corp.* *D Corp.* filed for bankruptcy and engendered a liability to a pension fund for a shortfall of *D Corp.*'s contributions. Under nonbankruptcy law, when *D Corp.* defaults to a pension trustee, the trustee is invited to sue *P Corp.*, which is deemed liable for the pension shortfall. The *Foodtown* court called this piercing the veil. It is no such thing. If a pension shortfall was grounds to pierce the corporate veil, then *any C_g* of *D Corp.* can get a money judgment against *P Corp.* But this is not the case. Only the pension trustee gets the money judgment against *P Corp.* The other *C_g* of *D Corp.* do not. It is apparent that what we have is a *guaranty* by *P Corp.* of *D Corp.*'s liability to the pension trustee. As a result, if *D Corp.* files for bankruptcy, the automatic stay does not prevent the pension trustee from suing *P Corp.* and levying upon *P Corp.*'s assets. Because this is not veil piercing, *P Corp.*'s property is not *D Corp.*'s property.

³² *Peacock v. Thomas*, 516 U.S. 349, 354 (1996) (“Piercing the corporate veil is not itself an independent ERISA cause of action, ‘but rather is a means of imposing liability on an underlying cause of action.’”) (citation omitted).

³³ Critics of piercing often object to the terminology of “alter ego” in piercing cases. But this is because courts erroneously purport to pierce on the grounds that the corporation and its shareholder are alter egos. We agree that this term does no analytical work. We argue, however, that “alter ego” is a useful term for the conclusion that piercing is appropriate. For example, we all know that Clark Kent and Superman are alter egos. This means that if Kent were to go bankrupt, his estate would include the contents of the Fortress of Solitude. See Schroeder & Carlson, *supra* note 31, at 510 n.22.

³⁴ See *infra* text accompanying notes 123–42.

³⁵ See, e.g., Steven M. Bainbridge, *Abolishing Veil Piercing*, 26 J. CORP. L. 479, 516–17 (2001).

³⁶ 296 F.3d 164, 169–72 (3d Cir. 2002).

3. Fraudulent Transfers

Suppose *D Corp.* conveys assets to *X*³⁷ in order to delay, hinder or defraud creditors. *D Corp.* has utterly alienated the asset and *X* now owns the *legal* title to the asset. But the creditors of *D Corp.* obtain an equity in *X*'s property that arises the minute *D Corp.* conveys legal title to *X*. The nature of this equity is that state law invites *C_l* to “avoid” the transfer. This means that *C_l* is entitled to have a court of equity declare that *C_l* has an equitable lien on *X*'s asset.³⁸ This, we think, is the best way to view fraudulent transfers, though, to be sure, there is prodigious confusion in the case law as to what a fraudulent transfer actually is.³⁹

In bankruptcy, *T* expropriates these fraudulent transfer rights from the *C_g*,⁴⁰ who are automatically stayed from competing with *T* for *X*'s fraudulently received asset.⁴¹ If *T* brings a fraudulent transfer suit against *X*, *T* is asserting that *D Corp.* and *X* are separate persons. In such a case, veil piercing is off the table. The trustee can compel *X* to return assets fraudulently transferred by *D Corp.* Or, alternatively, if *X* is *SH*, *T* can assert *SH*'s free and easy access to *D Corp.* assets as grounds to pierce the veil.⁴² *T* can therefore obtain the very same asset (and all other *SH* assets) from *SH* in a turnover proceeding, because *SH* is in control of property of the bankruptcy estate. For this reason, *T* often pleads fraudulent transfer and piercing as alternative causes of action.⁴³ This is because the same act might support these two very different theories of liability.

When such actions are settled, *SH* pays the settlement price and simultaneously buys back *SH*'s separate personhood *and* title to the fraudulently transferred asset. These settlements are binding on *C_l* because *T* represents all the *C_g* of *D Corp.* and *T* controls both the fraudulent transfer and veil piercing theories.⁴⁴

³⁷ We refer to the recipient as *X*, rather than *AD* because, in a fraudulent transfer case, *X* owes *nothing* to *D Corp.* and is therefore not a debtor of a debtor.

³⁸ The right between *C_l* and *C₂* to *X*'s asset is “first come first served.” David Gray Carlson, *Fraudulent Transfer as a Tort*, 2022 MICH. ST. L. REV. (forthcoming 2022).

³⁹ These issues are thoroughly reviewed in David Gray Carlson, *Fraudulent Transfers: Void and Voidable*, 28 AM. BANKR. INST. L. REV. 1 (2021).

⁴⁰ 11 U.S.C. § 544(b)(1) (2018). The *C_g* do, however, retain a residual interest in the fraudulent transfer right if *T* elects to abandon her rights to *X*'s fraudulently received asset. See, e.g., *Artesanias Hacienda Real S.A. de C.V. v. N. Mill Cap., LLC* (*In re Wilton Armetale, Inc.*), 968 F.3d 273, 283–84 (3d Cir. 2020).

⁴¹ See *The Am. Nat'l Bank of Austin v. MortgageAmerica Corp.* (*In re MortgageAmerica Corp.*), 714 F.2d 1266, 1273–74 (5th Cir. 1983). The case presumes that *D Corp.* can avoid the fraudulent transfers it has made, and *T* inherits this power from *D Corp.* See David Gray Carlson, *The Logical Structure of Fraudulent Transfers and Equitable Subordination*, 45 WM. & MARY L. REV. 157, 179–82 (2003).

⁴² See Schroeder & Carlson, *supra* note 31, at 532.

⁴³ See *Swift & Co. Packers v. Compania Colomb. del Caribe, S.A.*, 339 U.S. 684, 688 (1950); *Bennett v. Garner*, 913 F.3d 436, 441 (4th Cir. 2019); *Glob. Naps, Inc. v. Verizon New Eng. Inc.*, 603 F.3d 71, 80 (1st Cir. 2010).

⁴⁴ See *Tronox Inc. v. Kerr-McGee Corp.* (*In re Tronox Inc.*), 855 F.3d 84, 108 (2d Cir. 2017). An alter ego claim filed after a fraudulent transfer claim has been litigated is barred by *res judicata*. See *Basic Cap. Mgmt. v. Dynex Cap., Inc.*, 976 F.3d 585, 588 (5th Cir. 2020).

Settlements in this environment are often supported by channeling injunctions.⁴⁵ Once *SH* pays *T*, any given *C_I* is permanently barred from trying to make *SH* pay a second time.⁴⁶ This is just an articulation of accord and satisfaction, or *res judicata*. Once *SH* pays, *SH* is forever immune from subsequent suits for receipt of a fraudulent transfer and any liability of *D Corp.* to *C_I* based on the theory that *SH* is the alter ego of *D Corp.*

4. Joint and Several Liability

When *T* succeeds to *D Corp.*'s claims against *AD₁* and *AD₂* for a cause of action as to which they are jointly and severally liable, each typically has a right of contribution against the other if either is compelled to pay in full. In *Munford v. Munford (In re Munford)*,⁴⁷ *D Corp.* was bankrupt and *T* succeeded to such a cause of action. *T* settled with *AD₁* and the court enjoined *AD₂* from suing *AD₁* for contribution, with the proviso that *AD₂* could set off *AD₁*'s payment to *T* for the settlement. *AD₂* protested that the bankruptcy court was powerless to discharge *AD₁* from *AD₂*'s contribution right. The Eleventh Circuit properly upheld the court's power to bar the suit by Federal Rule of Civil Procedure 16, pertaining to pretrial conferences. According to Rule 16(c): "At any [settlement] conference, the court may consider and take appropriate action, [with respect to] . . . (I) settl[ement] [] and [the use of] special procedures to assist in resolving the dispute when authorized by statute or local rule."⁴⁸ According to the Eleventh Circuit, "[w]e conclude that section 105(a) and rule 16 taken together provide ample authority for the bankruptcy's court action."⁴⁹ Thus, to the extent that the bankruptcy court's settlement order extinguished *AD₂*'s right of contribution under state law,⁵⁰ this could not be laid at the doorstep of the Bankruptcy Code. The order was one that a federal court in a diversity action could have made.⁵¹ It is therefore best to view the

⁴⁵ See *In re Tronox Inc.*, 855 F.3d at 114.

⁴⁶ *Munford v. Munford (In re Munford)*, 97 F.3d 449, 454 (11th Cir. 1996).

⁴⁷ See *id.*

⁴⁸ FED. R. CIV. P. 16(c)(2).

⁴⁹ *In re Munford*, 97 F.3d at 455.

⁵⁰ See, e.g., N.Y. GEN. OLBIG. LAW § 15-108(b).

⁵¹ Ralph Brubaker, *An Incipient Backlash Against Nondebtor Releases? (Part I): The "Necessary to Reorganization" Fallacy*, 42 No. 2 BANKR. L. LETTER, at 4 (Feb. 2018) (providing barring contribution or indemnification claims "is a routine, accepted feature of even nonbankruptcy partial settlements (with less than all defendants). Indeed, the basic nature of common-law contribution and indemnity is such that an order barring contribution or indemnity claims by nonsettling co-defendants against a settling defendant simply gives full effect to the legal consequences of a plaintiff's partial settlement . . . even in the absence of the bar order."). In his paper, Professor Brubaker complains that the Eleventh Circuit transgressed the proper bounds of *Munford* in *Markland v. Davis (In re Centro Grp, LLC)*, No. 21-11364, 2021 WL 5158001 (11th Cir. Nov. 5, 2021), *aff'g Markland v. Centro Grp., LLC*, No. 20-cv-20610-KMW, 2021 WL 1705754 (S.D. Fla. Mar. 24, 2021). In the case, a creditors' committee of *D Corp.* settled a breach of fiduciary duty claim against a director. A shareholder objected that the settlement would preclude his claims against the director. According to the district court, "the bar order only enjoins those claims 'relating' to or 'arising in connection with' the released claims." *Centro Grp.*, 2021 WL 1705754, at *11 (citations omitted). Therefore, this case seems to our eye not to go beyond the result in *Munford*. If the shareholder did indeed have independent tort

third-party release as not a bankruptcy issue at all but rather an issue of federal court power.⁵²

To summarize, when *AD* settles with *T* with regard to *D Corp.*'s claim to breach of fiduciary duty, or to *T*'s property claims against *SH* based on piercing the veil, or *T*'s right to avoid fraudulent transfers, *AD*'s obligation to pay or turn over property is extinguished, and *res judicata* prevents *C₁* from suing *AD* again. Channeling injunctions that shield *AD* from unnecessary lawsuits are well within the equity powers of a bankruptcy court. If these are third-party releases, they are implicitly authorized by the Bankruptcy Code, something Judge McMahon conceded in the *Purdue* case.⁵³

B. Insurance Cases

Channeling injunctions and releases are routinely issued in mass tort cases involving insurance proceeds. The classic case is *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*.⁵⁴ In *Manville*, an insurance company (IC) agreed to pay the policy limit into a trust fund for the benefit of tort victims (whom we shall call the *C_v*). The *C_v* were limited to recovering from this fund. The other creditors of *D Corp.* had no access to this fund. A "channeling injunction" prohibited the *C_v* from exercising their state-law right of direct action against IC. *Manville* inspired the 1994 enactment of section 524(g), which will loom large in the story we shall tell.⁵⁵

The channeling injunction is justified by the fact that the policy was property of the bankruptcy estate. The *C_v* were in effect secured creditors with a lien on *D Corp.*'s accounts receivable.⁵⁶ Thus, *T* was liquidating property of the bankruptcy estate and reserving the proceeds for secured creditors with liens on this receivable. In effect, *T* was proceeding under Bankruptcy Code section 363(b). *T* was "using" property of the bankruptcy estate by collecting from IC. The proceeds collected are encumbered by the security interests the *C_v* are given by direct action statutes.

Now there is a doctrinal problem with this. *T* is supposed to be working for the

claims, the settlement did not preclude him from suing. The district court also added that "Mr. Markland failed to articulate specific claims he had" against the directors "or explain why they had a likelihood of success." *Id.* It appears to be correct that Mr. Markland, as a shareholder, had no claims. Only *D Corp.* had claims.

⁵² *AD₂* had protested that limiting *AD₂* to a setoff was unfair, but the Eleventh Circuit found the bankruptcy court was within its discretion to treat *AD*'s contribution right fairly. See *In re Munford*, 97 F.3d at 455–56.

⁵³ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 107 (S.D.N.Y. 2021).

⁵⁴ 843 F.2d 636, 639–41 (2d Cir. 1988). *Manville* was an asbestos mass tort case, litigated before Congress enacted Bankruptcy Code section 524(g), which we discuss separately. See *infra* text accompanying notes 65–73. Here, *Manville* stands for a case revolving around an insurance receivable.

⁵⁵ See *infra* text accompanying notes 65–73.

⁵⁶ See Joshua M. Silverstein, *Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies*, 78 UMKC L. REV. 1, 38 (2009) [hereinafter Silverstein, *Asbestos*]; cf. Menard-Sanford v. Mabey (*In re A.H. Robins Co.*), 880 F.2d 709, 717 (4th Cir. 1989) (finding the *C_v* "were third-party beneficiaries under the policy and as such had a common undivided interest in the value of the policy"); MacArthur Co. v. Johns-Manville Corp. (*In re Johns-Manville Corp.*), 837 F.2d 89, 93 (2d Cir. 1988), cert. denied, 488 U.S. 868 (1988).

benefit of *unsecured* creditors, not secured creditors. The insurance receivable is, by its nature, always over-encumbered. That is, under the terms of the insurance policy, the size of the insurance account receivable is measured by the aggregate claims of C_v — but not in excess of the policy limit. Consequently, by definition, there can never be a debtor surplus in such a receivable. The unsecured creditors ($C_g \setminus C_v$) cannot benefit from the settlement with IC. Yet courts tolerate T disposing of such over-encumbered property.

Pursuing the Article 9 analogy further, where AD owes $D Corp.$ an account encumbered by a security interest, $D Corp.$ has the right to modify its contract with AD , and the secured party is bound by the modification.⁵⁷ Similarly, in *Manville*-like cases, where IC disputes its liability under the policy,⁵⁸ T (who succeeds to the insurance receivable) has the right to modify/settle the IC's payment obligation, and the C_v =SP are bound by this.

Once it is conceded that T may “use” encumbered property (*i.e.*, collect the IC receivable), then the channeling injunction poses no difficulty. The injunction basically represents the principle of *res judicata*. $D Corp.$ had a chose in action against its IC. This chose in action passes to T because it is $D Corp.$'s pre-petition property. T can compel the IC to pay. The secured creditors (*i.e.*, the C_v) are bound by this settlement. Being a legitimate settlement, a channeling injunction appropriately protects IC. If there were no channeling injunction and if a C_v were to bring a direct action against IC, IC could defend on *res judicata* grounds.⁵⁹

We have portrayed *Manville* as the collection by T of an encumbered account receivable. In such a case, T 's settlement of the account is binding on the secured creditor (here, the C_v). A contrary case (cited by Judge McMahon) is *Landsing Diversified Properties II v. First National Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*,⁶⁰ where $D Corp.$ had a lawsuit against AD and an attorney (A) had a lien on the recovery. In the middle of the litigation, $D Corp.$ filed for bankruptcy and rejected the executory contract with A, which called for an hourly rate plus a contingency fee. The court miscalculated damages, arranged for payment of A and then awarded a permanent injunction against A from seeking to enforce its lien against AD . On appeal, the Tenth Circuit reversed as to the method of calculating damages. It read Oklahoma law as requiring a damage award for the lost

⁵⁷ See U.C.C. § 9-405(a) (“A modification of . . . an assigned contract is effective against an assignee if made in good faith.”); see also *id.* § 9-405(b) (“Subsection (a) applies to the extent that: (1) the right to payment or a part thereof under an assigned contract has not been fully earned by performance . . .”).

⁵⁸ See *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 636 (2d Cir. 1988).

⁵⁹ For this analysis to apply, the insurance policy must indeed be property of the bankruptcy estate. This was not the case in *Gillman v. Continental Airlines (In re Continental Airlines)*, where $D Corp.$ had purchased directors and officers (D&O) insurance for its directors and officers, in case they were sued for securities law torts. 203 F.3d 203 (3d Cir. 2000). The policy had a limit to it. *Id.* at 215. The chapter 11 plan provided that, if the insurance company (IC) paid the policy limit into the bankruptcy estate for the benefit of third parties with claims against the officers and directors, the IC would be protected by a permanent injunction barring “direct actions” by tort victims against IC. *Id.* at 216. Such a release was not confirmable because it confiscated the property right of the tort victims to recover directly from the IC. *Id.* at 217.

⁶⁰ 922 F.2d 592 (10th Cir. 1990), *modified on other grounds*, 932 F.2d 898 (10th Cir. 1991).

contingency fee. The award, however, would nevertheless be subject to the rule of Bankruptcy Code section 502(b)(4), which disallows a claim for attorney's fees to the extent "such claim exceeds the reasonable value of such services." The case was remanded on this score.

The Tenth Circuit, however, erroneously ruled that the permanent injunction prohibiting A from suing *AD* was not permitted. Thus, A was invited to recover a *reasonable* fee from the bankruptcy estate and then sue *AD* on its lien for *additional* (unreasonable) attorney's fees from *AD*. The injunction was clearly related to the court's *in rem* jurisdiction over *D Corp.*'s cause of action against *AD* and should have been sustained. The injunction prevents A from getting a *reasonable* fee from the bankruptcy court while getting *additional* fees from *AD* under Oklahoma law (which might enforce the contingency fee regardless of whether it was reasonable).

Deeply disturbing is the Tenth Circuit's assumption that where *AD* owes *D Corp.*, and where A is limited to a reasonable fee from bankruptcy, A can obtain the unreasonable balance from *AD*. But *AD* paid *T* a sum that comprehended A's reasonable fee. If now *AD* must pay *more* to A, then *AD* is surely entitled to restitution from *T*, meaning that the bankruptcy estate collects the tort receivable *minus* the unreasonable fee, which deprives section 502(b)(4) of any meaning. Surely the meaning of section 502(b)(4) is that, where A is limited to a reasonable fee, *AD* is liable for the fee as *federally determined*. The Tenth Circuit, however, pointed out that, if *D Corp.* eventually wins a discharge, *D Corp.* will not have to disgorge part of the overpayment *AD* mistakenly made to *T*:

Not only does such a permanent injunction improperly insulate nondebtors in violation of section 524(e), it does so without any countervailing justification of debtor protection — as discussed earlier, the discharge injunction provided for in section 524(a) already frees the debtor from potential derivative claims, such as indemnification or subrogation, that might arise from the creditor's post-confirmation attempts to recover the discharged debt from others.⁶¹

The solution in the Tenth Circuit is that *AD* must cover the reasonable fee when it pays *T* and then must pay an unreasonable fee to A and forego restitution from *T*. The justice and logic of this escapes us. Surely the bankruptcy estate is being unjustly enriched when it received *AD*'s payment, which was supposed to cover the *whole* legal fee owed to A. Prevention of unjust enrichment should be well within the equitable power of the bankruptcy court. A's suit against *AD* is an unjust enrichment, and Bankruptcy Code section 105(a) should be capacious enough to justify a channeling injunction against A. If so, then channeling injunctions against IC in mass tort cases are justified to prevent unjust enrichment of a given *C_v*.

⁶¹ *Id.* at 602.

C. Qualified Immunity

Another release commonly awarded favors personnel who administer the bankruptcy estate. In *In re Aegean Marine Petroleum Network, Inc.*,⁶² a bankruptcy court defended these releases as a form of qualified immunity. Thus, if an officer of the debtor-in-possession used proper business judgment, the officer had no liability to any third party who may have been harmed.

To some extent, these exculpation provisions are based on the theory that court-supervised fiduciaries are entitled to qualified immunity for their actions. While the reported case law is thin, however, I think that a proper exculpation provision is a protection not only of court-supervised fiduciaries, but also of court-supervised and court-approved transactions. If this Court has approved a transaction as being in the best interests of the estate and has authorized the transaction to proceed, then the parties to those transactions should not be subject to claims that effectively seek to undermine or second-guess this Court's determinations. In the absence of gross negligence or intentional wrongdoing, parties should not be liable for doing things that the Court authorized them to do and that the Court decided were reasonable things to do.⁶³

Injunctions barring actions against persons involved in administering the chapter 11 proceeding are routinely approved, provided they have a fraud exception.⁶⁴ Thus, a claim based on negligence falls within the qualified immunity of a participant, but liability for an intentional tort does not.⁶⁵

In *Lynch v. Mascini Holdings Ltd. (In re Kirwan Offices S.A.R.L.)*,⁶⁶ a shareholder of *D Corp.* challenged the bona fides of the *D Corp.*'s bankruptcy. He lost and then withdrew from participation. Anticipating the disgruntled shareholder would mount an attack on the plan, Judge Drain confirmed a plan provision that prevented anyone from suing because the confirmation order was improper. The injunction simply repeated what the law was anyway. "In short, the injunction affirmed in *Kirwan* was plainly one designed to preserve and protect the authority of the bankruptcy court and the integrity of its actions *vis à vis* the debtor's estate."⁶⁷ Although Judge McMahon affirmed Judge Drain in *Kirwan*, in retrospect

⁶² 599 B.R. 717, 720–21 (Bankr. S.D.N.Y. 2019).

⁶³ *Id.* (citations omitted).

⁶⁴ *See, e.g.,* SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (*In re Seaside Eng'g & Surveying, Inc.*), 780 F.3d 1070, 1081 (11th Cir. 2015), *cert. denied*, 577 U.S. 823 (2015); Airadigm Commc'ns, Inc. v. FCC (*In re Airadigm Commc'ns, Inc.*), 519 F.3d 640, 656–57 (7th Cir. 2008).

⁶⁵ *But see* Bank of N.Y. Tr. Co., N.A. v. Off. Unsecured Creditors' Comm. (*In re Pac. Lumber Co.*), 584 F.3d 229, 252 (5th Cir. 2009) (finding a creditors' committee entitled to a negligence exculpation but those who bought assets per the plan were not entitled).

⁶⁶ 592 B.R. 489 (S.D.N.Y. 2018), *aff'd*, 792 F. App'x 99 (2d Cir. 2019).

⁶⁷ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 103–04 (S.D.N.Y. 2021).

she was not so sure that such injunctions are authorized by the Bankruptcy Code.⁶⁸

Clearly they are. The *res judicata* effect of a court judgment is an inherent feature of any judgment, but in the case of a confirmed plan, *res judicata* is expressly legislated in the Bankruptcy Code. According to section 1141(a), “the provisions of a confirmed plan bind the debtor . . . and any creditor, equity security holder, or general partner in the debtor . . . whether or not such creditor, equity security holder, or general partner has accepted the plan.” The injunction simply repeated the premises of this provision and therefore was within the scope of section 105(a).

D. Asbestos Cases

Mass tort bankruptcy cases began with *Manville*.⁶⁹ The case involved *D Corp.*’s principal asset — an insurance policy paid out to *D Corp.* because *D Corp.* was liable to *C_v*. Such a case involves the administration of an encumbered asset and so has already been treated generally in a separate section. For the moment, we consider 1994 legislation passed by Congress to assure that the Bankruptcy Code vindicates what the *Manville* courts had achieved in the past.⁷⁰

Section 524(g) authorizes the release of third parties from derivative liabilities. When it does so, it does not comprehend theft of rights by the *C_v* to sue third parties.⁷¹ It also releases any entity that buys a factory from *D Corp.* from state-created successor liability.⁷² These releases are strictly limited to asbestos-related tort liabilities.

With regard to the derivative liabilities, the releases apply only to causes of action that, prior to bankruptcy, belonged solely to *D Corp.*, not to the *C_v*.

For instance, section 524(g)(3)(B)(ii) (preamble) refers to barring an action against a third party who “is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor” As Professor Joshua M. Silverstein has remarked, “This language suggests that supplemental injunctions may *not* extinguish rights against a third party arising from the *third party’s independent conduct*.”⁷³ For this proposition he cites *In re Combustion Engineering Inc.*,⁷⁴ a “jurisdiction” case we shall eventually investigate. In passing, the *Combustion* court remarked that the plain language of section 524(g) shows that the channeling injunction may not cover “non-derivative third-party actions.”⁷⁵

⁶⁸ *Id.* at 89 (“But in *Kirwan*, this Court did not analyze whether there was a statutory (as opposed to a jurisdictional or constitutional) basis for the injunction that was at issue in that case.”).

⁶⁹ For a history of the *Manville* litigation, see Silverstein, *Asbestos*, *supra* note 56, at 11–19.

⁷⁰ See Silverstein, *Asbestos*, *supra* note 56, at 55–56.

⁷¹ 11 U.S.C. § 524(g) (2018). On this there is no guidance from the legislative history. See Silverstein, *Asbestos*, *supra* note 56, at 56.

⁷² On the foreclosure of successor liability as an *in rem* concept, see Schroeder & Carlson, *supra* note 31, at 515–21.

⁷³ Silverstein, *Asbestos*, *supra* note 56, at 63 (emphasis in original); 11 U.S.C. § 524(g) (2018).

⁷⁴ 391 F.3d 190 (3d Cir. 2004).

⁷⁵ *Id.* at 235.

Section 524(g)(3)(B)(ii)(I) approves a permanent injunction barring suits against *AD* that arises because of *AD*'s "ownership of a financial interest in the debtor" This refers to piercing the corporate veil, a theory that (properly) belongs solely to *T*.⁷⁶ Such a theory asserts that *D Corp.* and *AD* are the same person. From this it follows that *AD*'s property is property of the bankruptcy estate, and the automatic stay prevents any *C_v* from pursuing a money judgment against *AD* because that constitutes a suit against *D Corp.* outside the bankruptcy proceeding. No property is being purloined from a *C_l* in this case.

In addition, section 524(g)(3)(B)(ii)(II) allows for the release of *AD* for liability stemming from "involvement in the management of the debtor . . . or service as an officer, director or employee of the debtor or a related party." This refers to *D Corp.*'s claim for breach of fiduciary duty owed by a director or officer to *D Corp.* Ordinarily, a *C_l* with a claim against *D Corp.* has no claim against a director or officer because *D Corp.* breached a contract or committed a tort against *C_l*. But *D Corp.* might argue from *D Corp.*'s liability to *C_l* that, by negligence or worse, the director or officer permitted *D Corp.* to incur the debt to *C_l*. Thus, the cause of action against *AD* belongs solely to *D Corp.*, not to *C_l*. At best *C_l* can garnish *AD*'s obligation to *D Corp.*, but this is barred by the automatic stay when *D Corp.* is bankrupt.⁷⁷

Fourth, section 524(g)(4)(A)(ii)(III) provides release for "provision of insurance to the debtor or a related party." This encompasses administration of property of the estate. The *C_v* are secured creditors as to an insurance receivable, and their rights are guaranteed by *D Corp.*'s obligation to provide adequate protection of the *C_v* property rights.

Finally, section 524(g)(4)(A)(ii)(IV) permits releases for:

[T]he third party's involvement in a transaction changing the corporate structure, or in a loan or other financial transaction affecting the financial condition, of the debtor or a related party, including but not limited to —

- (aa) involvement in providing financing (debt or equity), or advice to an entity involved in such a transaction; or
- (bb) acquiring or selling a financial interest in an entity as part of such a transaction

This seems to refer to lender liability to *D Corp.*, or breach of fiduciary duty to *D Corp.* The provision does not expropriate any right belonging directly to *C_l*.

⁷⁶ For some contrary authority, see Schroeder & Carlson, *supra* note 31, at 515–21.

⁷⁷ Professor Silverstein worries that this language covers officers who are joint tortfeasors with *D Corp.* The language of (II) refers to the officers' *direct* liability. Silverstein proclaims himself "[unconvinced] by this reading" and further notes that any managerial torts would have been committed many decades ago. Silverstein, *Asbestos*, *supra* note 56, at 65. Nevertheless, some very broad releases have appeared in chapter 11 asbestos plans, arguably transcending what section 524(g) permits. Silverstein, *Asbestos*, *supra* note 56 at 67–68.

In short, the asbestos amendments comprehend release of derivative claims and do not authorize theft of rights from the C_v .

In her opinion reversing confirmation in *Purdue*, Judge McMahon places great weight on a “knew how to” argument. Congress knew how to legalize theft plans in section 524(g). Therefore, Congress intends to ban theft in all other cases.⁷⁸ In our opinion, however, section 524(g) says nothing at all about theft plans, and nothing about theft plans can be learned from section 524(g), except perhaps the point that since, not even in asbestos cases was theft countenanced, it cannot be countenanced elsewhere.

E. Expropriation of Third-Party Rights

Does the Bankruptcy Code sanction expropriation of property by the bankruptcy estate from third parties? The answer is that it does, in certain narrow circumstances. The standard case of this is the fraudulent transfer. Suppose a debtor (D) owns a gold brick. Insolvent, D conveys the gold brick to X for no reasonably equivalent value. As a result of this gift, many (but not all) creditors of D (the C_g) have an *in rem* right in the brick itself (up to the amount of claim). X owns the balance of the brick. D retains no interest whatsoever in the brick. If D files for bankruptcy, all of D ’s pre-petition property is transferred to the bankruptcy estate, administered by T . In addition, the avoidance right of the C_g also became part of the bankruptcy estate.⁷⁹ The sole right to retrieve the brick from X now belongs to T . Therefore, the Bankruptcy Code, in this instance, involves transferring C_g ’s causes of action over to T , who then enforces these causes of action for the equal benefit of all the C_g .

Beyond that, the C_g with causes of action against AD retain their rights. For example, suppose C_l lends to D and D ’s friend AD guarantees payment. D ’s bankruptcy has limited — at best temporary — effect on C_l ’s right to obtain a money judgment against AD . If, in a chapter 11 plan, D , as debtor-in-possession, tries to obtain a permanent injunction against C_l ’s enforcement of the suretyship claim against AD , the order is *ultra vires*.

What provision in the Bankruptcy Code prevents such a third-party release of AD ? The Bankruptcy Code is surprisingly opaque on this question.⁸⁰ Judge McMahon was acutely aware of this lacuna. In discussing whether Bankruptcy Code section 1123(a)(5) authorizes theft plans, Judge McMahon noted that section 1123(a)(5) requires a plan to provides for its own implementation and provides examples of what this means. Many of them suggest modes of dealing with property of the bankruptcy estate. But none of them authorize a plan to peddle C_l ’s cause of

⁷⁸ See *In re Purdue Pharma, L.P.*, 635 B.R. 26, 110–11 (S.D.N.Y. 2021).

⁷⁹ 11 U.S.C. § 541(a)(3) (2018) (incorporating recoveries under section 550).

⁸⁰ See *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 656 (6th Cir. 2002) (“The Bankruptcy Code does not explicitly prohibit or authorize a bankruptcy court to enjoin a non-consenting creditor’s claims against a non-debtor to facilitate a reorganization plan.”) (internal citation omitted).

action to *AD* in exchange for a payoff:

Section 1123(a)(5) does not authorize a court to give its imprimatur to something the Bankruptcy Code does not otherwise authorize, simply because doing so would ensure funding for a plan. Nothing in Section 1123(a)(5) suggests that a debtor has the right to secure sufficient funds for implementation by any means necessary. Section 1123(a)(5) would not, for example, authorize a court to enter an order enjoining a bank from suing a non-debtor employee who embezzled funds and then offered them to her bankrupt brother's estate in exchange for a release of all claims a third party could assert against her. That example is silly, of course, but the point is simple: the mere fact that the money is being used to fund implementation of the plan does give a bankruptcy court statutory authority to enter an otherwise impermissible order to obtain that funding.⁸¹

Judge McMahon's "silly" example helps to emphasize the point that the Bankruptcy Code does not quite prohibit a bankruptcy court from sanctioning theft to facilitate implementation of funding the plan. Clearly she is right, but how to prove this from some axiom grounded in the Bankruptcy Code?

Probably the cleanest statutory bar is Bankruptcy Code section 1129(a)(3): "The plan has been proposed in good faith and not by any means forbidden by law."⁸² The provision fits the situation of the third-party release of *C_I*'s claim against *AD* — though it is a poor and awkward fit. Outside bankruptcy, no law "forbids" *D* from proclaiming that *C_I*'s suretyship action is discharged. Rather, it is the case that *D* has no power to discharge *C_I*'s cause of action against *AD*. Any proclamation of discharge by *D* is not illegal, but it *is* ineffective and meaningless — the gibbering nonsense of *D* that can be safely ignored. In spite of *D* speaking the words, *C_I* can proceed against *AD* and obtain a money judgment.

Expropriation of *C_I*'s right against *AD* is not authorized by nonbankruptcy law, however, because the release, we may say, is "forbidden." Nonbankruptcy law does not authorize it and, according to the Prussian view of things, the law forbids it.⁸³

⁸¹ *In re Purdue Pharma*, 635 B.R. at 109.

⁸² 11 U.S.C. § 1129(a)(3).

⁸³ According to an old joke, attributable to Newton Minow:

In Germany, under the law, everything is prohibited, except that which is permitted. In France, under the law, everything is permitted, except that which is prohibited. In the Soviet Union, under the law, everything is prohibited, including that which is permitted. And in Italy, under the law, everything is permitted, especially that which is prohibited.

This is awkward, but it gets the job done. It is clearly what the Bankruptcy Code intends. And it is the essence of Judge McMahon's opinion reversing confirmation.

It is certainly fair to think that the theme of Bankruptcy Code section 363 is that *T* may use, sell, or lease property of the estate, but not other people's property. Still, there are exceptions. *T* may sell a creditor's security interest (a "free and clear" sale) if "the price at which [debtor equity] is to be sold is greater than the aggregate value of all liens on such property."⁸⁴ When *T* does this, the sale generates proceeds, on which the secured party (SP) continues to have a security interest. Under Bankruptcy Code section 725, *T* must distribute proceeds to SP before distributing anything to the unsecured creditors.⁸⁵

Similarly, *T* may sell the property of *D*'s cotenant under certain circumstances (a partition sale).⁸⁶ But in these cases, *T* must compensate the third party for taking away the third party's property against the third party's will.

The lesson drawn from these examples is that the Bankruptcy Code, from time to time, authorizes nonconsensual takings⁸⁷ of property from third parties, but, when it does so, it compensates the third party for the value of that which was taken.

On the other hand, theft without compensation (*i.e.*, eminent domain) is not allowed. What deserves to be a lead case on this question is *In re Aegean Marine Petroleum Network Inc.*⁸⁸ In that case, Judge Michael E. Wiles was asked to confirm a plan that enjoined lawsuits against "a broad group of released parties."⁸⁹ These included members of the creditors' committee appointed in the chapter 11 case, advisors of that committee, agents of *D Corp.*, lenders to *D Corp.*, and indenture trustees. The group also included an entity (Mercuria) that provided DIP financing and also acquired the assets of *D Corp.*:

The proposed exculpation provision in the Plan provides generally that each exculpated party shall have no liability to anyone for any claim "related to any act or omission based on" (1) the Chapter 11 cases, (2) the restructuring support agreement, (3) the court-approved disclosure statement, (4) the Plan, (5) the Plan supplement, or (6) "any restructuring transaction, contract, instrument, release, or other agreement or document created or entered into in connection with the disclosure statement or the Plan," all of which is subject to a general exclusion for claims that are determined in a final order to have constituted actual fraud,

⁸⁴ 11 U.S.C. § 363(f)(3).

⁸⁵ *Id.* § 725.

⁸⁶ *Id.* § 363(h).

⁸⁷ Consensual releases seem not to be an issue, but one authority (over a dissent) holds that, where a creditor with a guaranty right is put into a class with weaker rights and where the plan requires a third-party release to share in a fund contributed by the third party, the obligee has not been treated equally in violation of Bankruptcy Code section 1123(a)(4). See *In re AOV Indus.*, 792 F.2d 1140, 1152 (D.C. Cir. 1986).

⁸⁸ 599 B.R. 717 (Bankr. S.D.N.Y. 2019).

⁸⁹ *Id.* at 720.

willful misconduct, or gross negligence.⁹⁰

Judge Wiles found the provision too broad. Taken literally, the plan barred suit on future breaches of the contracts entered into as part of the plan. The releases were:

[N]ot limited to transactions that occurred during the bankruptcy case or that this Court has supervised and previously approved. Instead, the proposed involuntary releases would immunize certain parties from all claims that are owned directly by creditors, stockholders, or other parties in interest (not by the Debtors) and that relate in any way to the Debtors, with no exceptions for claims alleging fraud or willful misconduct.⁹¹

Judge Wiles specifically noted that no evidence had been presented that the plan fully compensated the C_g whose claims were barred.

F. Eminent Domain

Plans that purloin third-party choses in action against AD for less than full compensation cannot be confirmed.⁹² But, controversially, some courts have permitted third-party releases when the plan fully compensates the C_g . These cases *take but compensate*.⁹³ To be sure, they also impose the risk on the C_g that the reorganized $D Corp.$ will fail to complete the plan payments. If that happens, the AD is off the hook and the C_g suffer the loss,⁹⁴ even though, under nonbankruptcy law, they would have the right to recover from AD .

The classic example of theft-plus-compensation is *Menard-Sanford v. Mabey*

⁹⁰ *Id.* at 721.

⁹¹ *Id.* at 722. Yet in the prior above-quoted passage, Judge Wiles says that plan *did* exclude claims alleging fraud or willful misconduct — an unacknowledged contradiction.

⁹² In 1997, Peter E. Meltzer reported:

[N]o court of appeals that has specifically considered § 524(e) in a nonasbestos case has ever affirmed an order confirming a plan of reorganization that contains a third-party release that binds creditors who either oppose the third-party release (and attendant injunction) or who are not being paid in full [on their claims under the plan].

Peter Meltzer, *Getting Out of Jail Free: Can the Bankruptcy Plan Process be Used to Release Nondebtor Parties?*, 71 AM. BANKR. L.J. 1, 30 (1997). Probably, the author meant that no plan has been confirmed that has bound objecting creditors *unless* they were paid in full on their claims. *E.g.*, *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 709, 720 (4th Cir. 1989).

⁹³ Arguably, the C_g who are compensated are deemed to *consent* to the plan. They are unimpaired and so are not even eligible to vote on the plan. 11 U.S.C. § 1124(1) (2018) (“leaves unaltered the legal . . . rights to which such claim . . . entitles the holder of such claim . . .”). See Dorothy Coco, *Third Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law*, 88 FORDHAM L. REV. 231, 235–36, 253 (2019).

⁹⁴ Silverstein, *Asbestos*, *supra* note 56, at 27.

(*In re A.H. Robins Co.*),⁹⁵ a mass tort products liability case. In *Robins*, IC engaged to pay the policy limits into the bankruptcy estate. This payment was thought to be sufficient to pay the $C_v + C_g$ in full.⁹⁶ A channeling injunction was issued to protect the IC from suit. The injunction also protected officers, directors and employees of *D Corp.* The Fourth Circuit justified the channeling injunction as a species of marshaling assets.

Before we assess this “marshaling of assets” analogy, we address the issue of whether *Robins* is really a bankruptcy case at all, or whether it is a class action case. If it is a class action case, then it illustrates the principle that class representatives can bind creditors to a settlement with whomsoever the representative chooses to make a defendant. Third parties are released no matter what the Bankruptcy Code says.

Under Federal Rule of Civil Procedure 23, classes can be certified under subparagraphs (b)(1) or (b)(2) or (b)(3). If a class is certified under (b)(1) or (b)(2), no member of the class may opt out and bring private litigation against any defendant. If the class is certified under (b)(3), individual creditors may opt out; the class representative is powerless to settle the claims of the opt-out creditors.⁹⁷

Thus, according to Rule 23(b), a class action may be maintained if Rule 23(a) is satisfied and if:

(1) prosecuting separate actions by or against individual class members would create the risk of:

- (A) inconsistent or varying adjudications with respect to individual class members that would establish incompatible standards of conduct for the party opposing the class; or
- (B) adjudication with respect to individual class members that, as a practical matter, would be dispositive of the interests other members not parties to the individual

⁹⁵ 880 F.2d. at 709.

⁹⁶ *Id.* at 720 (“The value of such unliquidated Dalkon Shield claims was fixed in the District Judge’s estimation order at an ‘aggregate’ dollar amount or value of \$2.475 billion. The District Judge announced to all parties interested in the reorganization that no plan of reorganization would be considered which failed to provide this amount for the full payment of all Dalkon Shield claims.”):

It is important to recognize that this case is closely tied in with the bankruptcy of Robins. Both this [class action against IC] and the Robins bankruptcy were before the same District Judge. Under the proposed settlement, the resolution of individual causation and damages for [the C_v seeking recovery from Robins] and [IC] is through the same mechanism. The Robins Plan of Reorganization and the *Breland* settlement are intended to provide full payment of all compensatory damages suffered by all Dalkon Shield claimants who have properly filed claims. . . . When the parties have funded the trust, Robins, [IC] and any successor corporations are relieved of any further liability, and this is proper since Dalkon Shield claimants will be paid by the Trust the full value of their claims.

Id. at 749. On the *Breland* settlement, see *infra* note 100.

⁹⁷ See *In re A.H. Robins Co.*, 880 F.2d at 728.

adjudications or would substantially impair or impede their ability to protect their interests; . . .
 (3) the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members, and that a class action is superior to other available methods for fairly and efficiently adjudicating the controversy
⁹⁸

How do we know that (b)(3) classes must include an opt-out? According to Rule 23(c)(2)(A), “appropriate” notice of the existence of the class action must be given to members of a (b)(1) or (b)(2) class. With respect to a (b)(3) class, however, “[t]he notice must clearly and concisely state in plain, easily understood language: . . . (v) that the court will exclude from the class any member who requests exclusion [and] (vi) the time and manner for requesting exclusion.” In other words, the notice required by (b)(3) actions must advertise the power to opt out.

In *Robins*, two classes were certified. Class A consisted of creditors who had timely filed proofs of claim in the *Robins* bankruptcy. This class was certified under both Rule 23(b)(1)(A) and (B).⁹⁹ The Class A creditors could not opt out. Therefore, release of any defendant named in class action A was binding on Class A without any aid of plan confirmation.¹⁰⁰ So far, one could say that *Robins* was a class action case, not a case in which plan confirmation eliminated third-party rights against a nondebtor defendant.

Class B, however, consisted of creditors who had not timely filed proofs of claim in the bankruptcy. These creditors were deeply subordinated in priority.¹⁰¹ They therefore concocted the theory, described by the Fourth Circuit as “tenuous,” that IC had committed a tort against the *C_v*. That is, IC’s liability was not just based on the contents of the policy. Rather, IC had affirmatively committed a tort by involving itself with the manufacture and sale of the Dalkon Shield.¹⁰² Class B reached settlement with the defendants. To the extent the *C_v* did not opt out, they were bound under Rule 23 to accept the settlement. So far, *Robins* is still not a bankruptcy case.

⁹⁸ FED. R. CIV. P. 23(b)(3).

⁹⁹ *In re A.H. Robins Co.*, 880 F.2d at 717.

¹⁰⁰

In *Breland* [88 B.R. 755], we also approved the class action settlement, which expressly bars the members of class A and the members of class B who did not opt-out from further prosecuting their Dalkon Shield claims other than pursuant to the terms of the settlement. Given this bar from pursuing compensation for their Dalkon Shield injuries, other than pursuant to the order, the [channeling] injunction complained of has no real effect on the rights of members of class A and the members of class B who have not exercised their right to opt-out.

Id. at 701.

¹⁰¹ 11 U.S.C. § 726(a)(3) (2018).

¹⁰² See *In re A.H. Robins Co.*, 880 F.2d at 719–20.

A very small number of the class B creditors *did* opt out, and so an injunction under Bankruptcy Code section 105(a) was indeed necessary to bar them from suing non-debtors:

The Plan's injunction, therefore, only has real impact upon members of Class B who have elected to opt-out of the *Breland* settlement. The injunction under sections 1.85 and 8.04 of the Plan prevents these claimants from suing all third parties other than "insurers[s]" (which includes Aetna) and claims based exclusively on medical malpractice. The class B members who have elected to opt-out . . . claim to have causes of actions as joint tortfeasors with Robins against Robins' directors, Aetna, and law firms who represented both Robins and Aetna. A suit against any of the parties mentioned by the class B opt-out members would affect the bankruptcy reorganization in one way or another such as by way of indemnity or contribution.¹⁰³

Thus, a few creditors were deprived of their right to sue non-debtors directly. This is partly unobjectionable because the IP that was paid into the settlement trust was property of the bankruptcy estate. But many *C_v* were prepared to allege that IC was a joint tortfeasor directly liable to the *C_v*,¹⁰⁴ and this lawsuit they could bring, as the plan did not protect IC from this particular lawsuit. The *C_v* also lost any right to sue an officer on a tort theory involving conspiracy or "aiding and abetting." As such, these were expropriative plans. But the plans also proposed to compensate the *C_g* in full for the expropriation.

The *Robins* court thought the plan was analogous to "marshaling of assets".¹⁰⁵

Given the impact of the proposed suits [against *AD*] on the bankruptcy reorganization and the fact that the class B members who chose to opt-out could have had their claims fully satisfied by staying within the settlement, the bankruptcy court's equitable powers support the questioned injunction. We think the ancient but very much alive doctrine of marshalling of assets is analogous here. A creditor has no right to choose which of two funds will pay his claim. The bankruptcy court has the power to order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors. Here, the carefully designed reorganization

¹⁰³ *Id.* at 701. On the *Breland* settlement, see *supra* note 96.

¹⁰⁴ See *In re A.H. Robins Co.*, 880 F.2d at 722 ("Aetna's liability as a possible joint tortfeasor was rather tenuous . . .").

¹⁰⁵ We are admonished to spell "marshaling" with a single *l*. *In re Vt. Toy Works, Inc.*, 82 B.R. 258, 265 n.2 (Bankr. D. Vt. 1987) (Conrad, J.), *rev'd on other grounds*, 135 B.R. 762 (D. Vt. 1991).

of Robins, in conjunction with the settlement in *Breland*, provided for satisfaction of the class B claimants. However, some chose to opt-out of the settlement in order to pursue recovery for their injuries from [IC] or from medical providers for malpractice. It is essential to the reorganization that these opt-out plaintiffs either resort to the source of funds provided for them in the Plan and *Breland* settlement or not be permitted to interfere with the reorganization and thus with all the other creditors. Since they have chosen opt-out rather than payment in full, they may have no complaint about a restriction placed on their ability to sue others.¹⁰⁶

So *Robins* is a bankruptcy case after all. It relies on a third-party release in a chapter 11 plan in favor of officers of Robins.

Does *Robins* meet the traditional requirement of marshaling assets? Marshaling assets is an equitable doctrine¹⁰⁷ that a junior secured party may invoke against a senior secured party.¹⁰⁸ The requirements for marshaling are as follows: (1) there must be two pools of collateral;¹⁰⁹ (2) one creditor is senior as to both pools; another creditor is junior as to only one pool; (3) a court has jurisdiction over both pools of collateral;¹¹⁰ (4) no inconvenience of any sort will be caused to the senior secured party; and (5) no third secured party will be harmed by marshaling.¹¹¹ If all these elements are present, a court of equity will insist that the senior secured party pursue the singly-encumbered collateral, thereby liberating the doubly-encumbered

¹⁰⁶ See *In re A.H. Robins Co.*, 880 F.2d at 701–02 (citations omitted).

¹⁰⁷ According to Justice Tom Clark:

[I]t is well to remember that marshaling is not bottomed on the law of contracts or liens. It is founded instead in equity, being designed to promote fair dealing and justice. Its purpose is to prevent the arbitrary action of a senior lienor from destroying the rights of a junior lienor or a creditor having less security. It deals with the rights of all who have an interest in the property involved and is applied only when it can be equitably fashioned as to all of the parties.

Meyer v. United States, 375 U.S. 233, 237 (1963).

¹⁰⁸ See *In re Vt. Toy Works, Inc.*, 82 B.R. at 290 (suggesting the marshaling of assets is “an equitable principle [designed] to benefit junior secured creditors”).

¹⁰⁹ *Warren v. Warren*, 30 Vt. 530, 535 (1858) (Poland, J.) (“When one man holds security on two funds, with perfect liberty to resort to either for his pay, and another party has security upon only one of the same funds, equity will compel the first to exhaust the fund upon which he alone has the security, before taking any part of the other, and thereby depriving the other party of his security.”).

¹¹⁰ Sometimes it is said that there must be a common debtor. See *In re Gibson*, 7 B.R. 437, 440 (Bankr. N.D. Fla. 1980), *vacated by Peacock v. Gibson*, 81 B.R. 79 (N.D. Fla. 1981). But this is not necessarily so. See Māny Amenzadeh, Note, *Marshaling in Bankruptcy: Questioning the Recent Expansions of the Common Debtor Requirement*, 30 DUQ. L. REV. 309, 314, 316 (1992) (listing expansions). In *Chittenden Trust Co. v. Sebert Lumber Co. (In re Vermont Toy Works, Inc.)*, the court thought that if a corporate debtor is merely the alter ego of the shareholder, there is no problem in marshaling the assets of debtor and shareholder, presumably because the same bankruptcy court has jurisdiction over both estates. 82 B.R. at 291–92, 300–09; *but see* 135 B.R. at 770–73 (reversing because the facts did not warrant piercing the corporate veil).

¹¹¹ *Shedoudy v. Beverly Surgical Supply Co.*, 161 Cal. Rptr. 164, 166 (Cal. Dist. Ct. App. 1980).

collateral to the benefit of the junior secured party.

The plan in *Robins* arguably meets these criteria: (1) there were two pools of collateral (broadly defined). An opting-out C_l had two options — taking 100% payment under the plan or pursuing an *in personam* tort theory against an officer. (2) C_l was not exactly senior as to both pools, but priority is irrelevant because the pool to which C_l was directed was adequate to compensate C_l in full. (3) The bankruptcy court had jurisdiction over the officers because the officers owe *D Corp.* for breach of fiduciary duty, and because the officer's negligence or bad judgment caused *D Corp.* to be liable to C_l . (4) No inconvenience was imposed on C_l , because C_l could simply take the payment tendered by the chapter 11 plan. (5) No third party was harmed because C_l was directed toward the plan and away from the officers.

The Fourth Circuit thought it fair that the few opt-outs be deprived of a right to sue officers because they could join the settlement and be paid “in full.” But there was hidden unfairness in this. The settlement simultaneously proclaimed what the opt-in claim was *and* that it was fully paid. But an opt-out creditor could hope for a jury verdict well to the north of the settlement amount, plus a deep pocket in which to indulge the claim. The confirmation order, therefore, had the effect of coercing the opt-outs to opt *in* after all. Yet the Fourth Circuit viewed the opt-out claims against non-debtors as “tenuous.” The court seemed unwilling to let a few creditors with tenuous claims against corporate officers sink the whole plan. These C_v were holdouts, and chapter 11 is all about squelching holdouts through voting. Thus the opt-outs were deprived of the opportunity to roll the dice at long odds outside bankruptcy. This arguably could be viewed as uncompensated theft.

Most of the *Robins* case must be viewed as a structured settlement of a class action, where creditors were compelled to accept risky cash flow in lieu of the chance to recover a sum certain presently. Only a tiny corner of *Robins* relies on third-party releases under the Bankruptcy Code. In *Class Five Nevada Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*,¹¹² the court found that, where a *class* of creditors has rejected the plan (so that cram down is triggered), the judgment that the plan fully pays the class must be accompanied by “adequate protection to meet the full payment requirement.” Technically, cram down applies only when the class in which the objectant has been placed had voted against the plan. But it seems no stretch to read *Dow Corning* as prohibiting the export of risk of nonpayment from the released third party to the C_v who supposedly are to be paid in full by the plan. This requirement takes most of the wind out of the sails of *Robins*, to the extent *Robins* can be read as foisting on creditors a risky chance of full recovery.¹¹³

¹¹² 280 F.3d 648, 659 (6th Cir. 2002).

¹¹³ Adequate protection in *Dow Corning* draws an idiosyncratic definition. The two members of Class 15 under the plan were Manitoba, Alberta and the United States. Each of these governmental entities were given the right to subrogate to the rights of C_v whose expenses were met by the government. The Canadian provinces had adequate protection. If the provinces discovered that a C_v was seeking compensation from the trust that properly should be paid to the province (because the province already paid the C_v for that expense),

Some twenty years ago, Professor Joshua Silverstein argued that the Supreme Court, has, by implication, already approved theft-and-compensation plans. In *United States v. Energy Resources*,¹¹⁴ *D Corp.* confirmed a plan that required that the Internal Revenue Service be paid in full for back taxes over six years, a plan term authorized and required by section 1129(a)(9)(C).¹¹⁵ Some of these taxes were so-called trust fund taxes, where *D Corp.* was appointed tax collector for the IRS *vis a vis* its employees.¹¹⁶ Under tax law, officers and employees of *D Corp.* responsible for collecting the taxes are liable to the IRS for these taxes if they are not paid. The IRS thus has third-party rights against these *AD* — “responsible persons” under the Internal Revenue Code.

The IRS appealed the confirmation order, claiming that the plan provision directing the trust fund tax be first paid increased the risk to the IRS. If the plan payments were not completed, the early dollars paid to the IRS in effect extinguished *AD*’s liability for the trust fund taxes. The remaining debt to the IRS could not be collected from these control persons. The Supreme Court held that the allocation provision was authorized by Bankruptcy Code section 11243(b)(6) — a plan may include any other appropriate provision not inconsistent with the applicable provisions of this title. Thus, chapter 11 plans can shift the risk from *AD* to the *C_g* in eminent domain plans.

A weakness in the Silverstein reading of *Energy Resources* (which Professor Silverstein acknowledged) is that the control persons were never released from their

the province could alert the trust, and the trust would freeze the funds until the ownership dispute was resolved. The United States, however, was given no such opportunity. Presumably, the Sixth Circuit’s notion was that, if a *C_v* already paid by the United States were to apply for a payment already covered by the United States, the trust would be obliged to pay the *C_v*. True, the United States would have the right to restitution from the *C_v*. But this recovery was risky. Therefore, the United States was not adequately protected. *Id.* at 655, 660–61. But for this risk, the United States was otherwise looking to full reimbursement. So the plan was of the eminent-domain variety. There is nevertheless also the hint that the *AD* protected in the plan were shareholders of *D Corp.* If so, the claims against the *AD* were piercing claims. If *this* is true, we have a settlement plan, which can be confirmed with compensation in full of any given creditor.

¹¹⁴ 495 U.S. 545 (1990); see Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate over Non-Debtor Releases in Chapter 11 Reorganizations*, 23 EMORY BANKR. DEV. J. 13 (2006) [hereinafter Silverstein, *Hiding in Plain View*].

¹¹⁵ According to this provision, the plan must:

[W]ith respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive an amount of such claim regular installment payments in cash —

- (i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;
- (ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, or 303; and
- (iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for in the plan (other than cash payments made to a class of creditors under section 1122(b)).

11 U.S.C. § 1129 (a)(9)(C) (2018).

¹¹⁶ 26 U.S.C. §§ 3102(a), 3402(a).

liability to the IRS. The IRS could, at any time, collect from the control persons instead of waiting out payment under the plan. Thus, it is hard to say that the plan released the *AD*. But Professor Silverstein defends his reading by reference to a federal statute barring injunctions against the IRS to collect a tax. But for this anti-injunction statute, Professor Silverstein insists, the plan could have released the control persons and limited the IRS to payment (in full) pursuant to the plan. Still, one must admit that the Supreme Court did *not* have a third-party release before it, and so the Supreme Court did not exactly uphold confirmation of an eminent domain plan.¹¹⁷

Energy Resources does seem to stand for the proposition that, according to the Supreme Court, a plan may swap payment of a sum certain for a risky payment over time. Judge McMahon, however, disagreed with this interpretation of *Energy Resources* in her opinion reversing Judge Drain. She need not have reached the issue since the *Purdue plan* is not compensatory. Judge McMahon's attitude seemed to be that either no third-party release is permitted or *all* third-party releases are permitted. Therefore, she felt obliged to show that *Energy Resources* had nothing to say about releases at all.

In her view of *Energy Resources*, the IRS had a "liability" under the Bankruptcy Code. The nature of this liability was that the IRS could be crammed down with payments over five years.¹¹⁸ But the IRS also had "rights." It had a right, say, to avoid cram down over eight years or cram down at 90 cents on the dollar of tax debt. In *Energy Resources*, the IRS was guilty of trying to expand its "rights" through equitable orders of the bankruptcy court. Said Judge McMahon:

Congress legislated a particular right into the Bankruptcy Code; the Supreme Court refused to allow lower courts to expand that right and held that the Bankruptcy Court had the power to authorize anything that was not inconsistent with that right. But the Bankruptcy Code conferred a specific right [on the IRS]. In [*Purdue*], there is nothing in the Bankruptcy Code that specifically authorizes the [third-party release]; the Bankruptcy Court (and this Court) is being asked to insert a right that does not appear in the Bankruptcy Code in order to achieve a bankruptcy objective. This is precisely [sic] what *Dairy Mart* and *Metromedia* prohibit.¹¹⁹

¹¹⁷ See Silverstein, *Hiding in Plain View*, *supra* note 114.

¹¹⁸ 11 U.S.C. § 1129(a)(9)(C)(ii). In 1994, section 1129(a)(9)(C) entitled the IRS "deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim." See 11 U.S.C. § 1129(a)(9)(C) (1994), amended by 11 U.S.C. § 1129(a)(9)(C)(ii) (2010).

¹¹⁹ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 113–14 (S.D.N.Y. 2021). *New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc.* (*In re Dairy Mart Convenience Stores, Inc.*), 351 F.3d 86 (2d Cir. 2003), and *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136 (2d Cir. 2005) are two governing (and problematic) precedents we shall visit with at length. See *infra* text accompanying notes 158–70 and 204–09.

Thus, Judge McMahon disposed of *Energy Resources* into a Prussian precedent. What is not allowed is forbidden. But it seems very French to us — what is not forbidden is allowed!

II. THE PURDUE PHARMA PLAN

What kind of release occurred in *Purdue Pharma*? In *Purdue*, the C_g did not receive payment in full. The plan provided for the *AD* — shareholders, directors and officers of *D Corp.* — to pay a sum to *T*. If *Purdue* represents a settlement of *T*'s various causes of action against *AD*, the release of *AD* was appropriate and Judge Drain acted rightly. If the release involved theft of third-party rights against *AD*, the plan was not confirmable and Judge Drain's confirmation order merited a reversal.

The release in the *Purdue plan* is profoundly difficult to read, no doubt because it was drafted by a committee of lawyers who billed by the hour, not by elegance of the product. That said, we read the plan as a “settlement” of *T*'s causes of action against *AD* and, as such, the plan was definitely confirmable. Here is section 10.7(b) in full prolixity:

As of the Effective Date, for good and valuable consideration, the adequacy of which is hereby confirmed, and except as otherwise explicitly provided in the Plan or in the Confirmation Order, the *Shareholder Released Parties*, other than any Shareholder Released Parties identified in clause (vii)(C) of the definition of Shareholder Released Parties (and in no other clause of such definition), *shall be conclusively, absolutely, unconditionally, irrevocably, fully, finally, forever and permanently released*, subject to clause (z) of the last paragraph of this Section 10.7(b), *by the Releasing Parties*¹²⁰ *from any and all Causes of Action*,¹²¹ *including any derivative*

¹²⁰ Releasing Parties is defined as:

“(I) [T]he Supporting Claimants, solely in their respective capacities as such, (ii) all Holders of Claims (whether or not asserted, transferred, hypothecated, waived, Allowed, allowable, choate, known, accrued, treated under this Plan or otherwise) against, or Interests in, the Debtors, (iii) all Holders of Future PI Claims, (iv) the Settling Co-Defendants, (v) with respect to each of the Persons in the foregoing clauses (i) and (iv), each of their Related Parties and (vi) each of the Debtors' Related Parties, in each case, other than any Shareholder Released Party.”

Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors, *In re Purdue Pharma*, No. 19-23649 (Bankr. S.D.N.Y. Sept. 2, 2021), ECF No. 3726. Supporting Claimants is defined as various creditors' committees. *Id.* “Holders of Claims” is defined as persons with claims against *D Corp.* *Id.* A “Future PI Channeled Claim” is:

[A]ny alleged opioid-related personal injury or similar opioid-related Cause of Action

claims asserted or assertible by or on behalf of the Debtors or their Estates and including any claims that any Releasing Party, or that any other Person or party claiming under or through any Releasing Party, would have presently or in the future been legally entitled to assert in its own right (whether individually or collectively) or on behalf of any Releasing Party or any other Person, notwithstanding section 1542 of the California Civil Code or any law of any jurisdiction that is similar, comparable or equivalent thereto (which shall conclusively be deemed waived), whether existing or hereinafter arising, in each case, (x) based on or relating to, or in any manner arising from, in whole or in part, (i) the Debtors, as such Entities existed prior to or after the Petition Date (including the Debtors' Opioid-Related Activities, manufacture, marketing and sale of Products, interaction with regulators concerning Opioid-

against any Released Party or Shareholder Released Party based on or relating to, in any manner arising from, in whole or in part, the Debtors, as such Entities existed prior to or after the Petition Date (including the subject matter described in subclause (i) of Sections 10.6(b) and 10.7(b) of the Plan), the Estates or the Chapter 11 Cases, and that is not (i) a PI Channeled Claim, a Third-Party Payor Channeled Claim, an NAS Monitoring Channeled Claim, a Hospital Channeled Claim or an Administrative Claim, (ii) held by a Domestic Governmental Entity or (iii) a Released Claim against any Debtor or its Estate, NewCo or any successor owner of NewCo's opioid business in each case, that arises from or relates to the use of an opioid that is manufactured by or placed in the stream of commerce by NewCo or any successor owner NewCo's opioid business. Future PI Channeled Claims shall be channeled solely to the PI Futures Trust in accordance with the Master TDP.

Id.

¹²¹ "Cause of Action" is a defined term which is itself prolix. Here are some of those words:

"Cause of Action" means any Claim, action, class action, claim, cross-claim, counterclaim, third-party claim, cause of action, controversy, dispute, demand, right, Lien, indemnity, contribution, rights of subrogation, reimbursement, guaranty, suit, obligation, liability, debt, damage, judgment, loss, cost, attorneys' fees and expenses, account, defense, remedy, offset, power, privilege, license or franchise, in each case, of any kind, character or nature whatsoever, asserted or unasserted, accrued or unaccrued, known or unknown, contingent or non-contingent, matured or unmatured, suspected or unsuspected, liquidated or unliquidated, disputed or undisputed, foreseen or unforeseen, direct or indirect, choate or inchoate, secured or unsecured, allowable or disallowable, Allowed or Disallowed, assertible directly or derivatively (including, without limitation, under alter-ego theories), in rem, quasi in rem, in personam or otherwise, whether arising before, on or after the Petition Date, arising under federal or state statutory or common law, or any other applicable international, foreign or domestic law, rule, statute, regulation, treaty, right, duty, requirement or otherwise, in contract or in tort, at law, in equity or pursuant to any other theory or principle of law, including fraud, negligence, gross negligence, recklessness, reckless disregard, deliberate ignorance, public or private nuisance, breach of fiduciary duty, avoidance, willful misconduct, veil piercing, unjust enrichment, disgorgement, restitution, contribution, indemnification rights of subrogation and joint liability, regardless of where in the world accrued or arising.

Id. We read "joint liability" to mean a theory whereby the Sacklers were liable for the acts of *D Corp.* It does not include a cause of action based on the tortious acts of the Sacklers.

Related Activities or Products, and involvement in the subject matter of the Pending Opioid Actions, and the past, present or future use or misuse of any opioid by a Releasing Party), (ii) the Estates or (iii) the Chapter 11 Cases and (y) as to which *any conduct, omission or liability of any Debtor or any Estate* is the legal cause or is otherwise a legally relevant factor.

In addition, as of the Effective Date, notwithstanding anything to the contrary herein, each Shareholder Released Party shall be released by any Person (regardless of whether such Person otherwise is a Releasing Party) that is a Shareholder Released Party's current or former officer, director, principal, member, employee, financial advisor, attorney (including, without limitation, any attorney retained by any director, in his or her capacity as such), accountant, investment banker (including, without limitation, investment banker retained by any director, in his or her capacity as such), consultant, expert or other professional, from any Cause of Action for indemnification, contribution or any similar liability-sharing theory based on or relating to, or in any manner arising from, in whole or in part, the subject matter of the preceding paragraph.

For the avoidance of doubt and without limitation of the foregoing, each Person that is a Governmental Unit or a Tribe shall be deemed to have released all Shareholder Released Claims that have been, are or could have been brought by (1) such Governmental Unit or Tribe in its own right, in its *parens patriae* or sovereign enforcement capacity, or on behalf of or in the name of another Person or (2) any other governmental official, employee, agent or representative acting or purporting to act in a *parens patriae*, sovereign enforcement or quasi-sovereign enforcement capacity, or any other capacity on behalf of such Governmental Unit or Tribe.

Notwithstanding anything herein to the contrary, (x) nothing in the Plan shall release any Excluded Claim; (y) nothing in this Section 10.7(b) shall (A) release any Non-Opioid Excluded Claims or (B) be construed to impair in any way the Effective Date or post-Effective Date rights and obligations of any Person under the Plan, the Plan Documents, the Confirmation Order or the Restructuring Transactions, including the Shareholder Settlement Agreement and the Separation Agreements; and (z) upon the filing of a Notice of Shareholder Release Snapback, (A) the Shareholder Releases set forth in this Section 10.7(b) shall be entirely null and void, revoked and invalidated, as of the Effective Date, with respect to all members of the Breaching Shareholder Family Group and the

Designated Shareholder Released Parties and (B) the status quo ante shall be restored in all respects for the Releasing Parties with respect to the members of the Breaching Shareholder Family Group and the Designated Shareholder Released Parties; provided that, for the avoidance of doubt, notwithstanding the nullification, voiding, revocation and invalidation pursuant to the foregoing clause (A), the Shareholder Releases shall continue in effect for, and shall be fully enforceable by and for the benefit of, all other Shareholder Released Parties other than the Breaching Shareholder Family Group and the Designated Shareholder Released Parties.¹²²

Or, in redacted form: “the Shareholder Released Parties, . . . shall be released . . . by the Releasing Parties from any and all Causes of Action . . . relating to . . . (i) the Debtors . . . [or] conduct, omission or liability of any Debtor . . . is the legal cause or is otherwise a legally relevant factor.” Quite a dense trio of sentences! Here is our paraphrase translated into third-grade-level language:

T releases *AD* for any claim *T* or *D Corp.* could bring in its own right based on opioids. The clause forbids any *C_i* from stepping into *D Corp.*’s shoes and bringing an action that *D Corp.* could have brought. But where *C_i* has its *own* claim against a Shareholder Released Party based on an act committed by such a party in his individual capacity, such a claim is not released.

That is, the literal language of 10.7(b) does not expressly release the Sacklers or other Shareholder Released Parties from their own personal tortious acts, probably because such a third-party release is not permissible (as Judge McMahon correctly decides). It only releases them for their responsibility for the acts of the debtors -- everything else in the provision modifies this basic release. Consequently, we think that this clause does not constitute a theft of any claim a given *C_i* owns against *AD*.

What kind of action is barred by section 10.7? For example, suppose a bank creditor of *D Corp.*, dissatisfied by the plan, were to bring a Delaware derivative action purporting to represent *D Corp.* in suing *AD* for breach of fiduciary duty. *D Corp.* will already have collected this claim against *AD* (if the plan is confirmed). The claim no longer exists. The bank’s attempt to bring the derivative action constitutes an opt-out by the bank of the settlement. Only *T* controls this cause of action and *T* may settle it. Under state law, the bank may be able to step into the shoes of *D Corp.* and enforce *D Corp.*’s causes of action. But all pre-petition causes of action have passed to *T* and *D Corp.* does not own them anymore. Therefore, the bank may not hijack the claim on behalf of *D Corp.* away from *T*.

Or suppose *C_i* \subset *C_v* seeks to sue a Sackler family member — one who was never

¹²² *Id.* (emphasis added).

an officer or director — for having received a fraudulent transfer. One of *T*'s theories was that *D Corp.* for years had been issuing dividends to all sorts of Sackler entities. But *T* had a right to settle the fraudulent transfer actions. *C_I* is bound by the settlement and may not go behind it in pursuit of fraudulent transfers. The Sackler entities in effect had bought back the fraudulent dividends when they settled with *D Corp.*

Section 10.7 does not cover claims other than breach of fiduciary duty, fraudulent transfer or piercing the veil. Suppose, for example, that *C_I* took OxyContin and was injured. *C_I* claimed that *D Corp.* and a corporate officer (*AD*) had conspired to make false statements about the safety of the product. The allegation is that *D Corp.* and the officer had conspired to tell a falsehood and that the officer had taken steps to effectuate this scheme. Section 10.7 does not affect any such lawsuit. *C_I* is entitled to file her complaint in state court, and *AD* will be obliged to answer the claims on the merits. The reason why *C_I* can proceed is that *C_I* is not attempting to step into the shoes of *D Corp.* and sue *AD* for breach of some duty *AD* owed to *D Corp.* *C_I* is asserting a cause of action that could only belong to *C_I*.

For example, in *State v. Ralph Williams' N.W. Chrysler Plymouth*¹²³ (cited by Judge Drain),¹²⁴ *X* was the president and sole shareholder of *D Corp.*,¹²⁵ an automobile dealership in Seattle. The Washington State Attorney General brought and prevailed in actions against *X* and *D Corp.* for fraudulent and deceptive trade practices in violation of the state Consumer Protection Act, seeking civil penalties, restitution of consumers' property and a permanent injunction against future deceptive practices.¹²⁶

The appeal primarily concerned the imposition of court costs and a bond against the defendant's lawyer who sought to withdraw from the case for conflicts of interest that arose when a fourth individual defendant he represented settled with the state. In appealing this award, *X* and *D Corp.* raised many procedural and substantive potential defenses. The vast majority of these are not relevant to this discussion.

One offered defense, however, concerned the personal liability of *X*. *X* argued that he could not be sued by the state because the trial court did not pierce the corporate veil to find that he was the alter ego of *D Corp.*¹²⁷ The Washington Supreme Court held that this *X*'s liability did not depend on piercing the corporate veil.¹²⁸ Rather, *X* did bad acts in his personal capacity:

¹²³ 553 P.2d 423 (Wash. 1976).

¹²⁴ See *In re Purdue Pharma L.P.*, 633 B.R. 53, 108 (Bankr. S.D.N.Y. 2021).

¹²⁵ Actually, multiple corporations were involved, but we have substantively consolidated them into *D Corp.* for simplicity.

¹²⁶ WASH. REV. CODE § 19.86.140 (2021). The City of Seattle, which objected to the plan, had claims against the Sacklers under this provision.

¹²⁷ In contrast, the court did find that the two corporate entities were alter egos of each other.

¹²⁸ Indeed, as we argue elsewhere, the propositions that *X* is *D*'s alter ego and that *X* is individually liable are not merely separate, but mutually inconsistent theories, of liability. See Schroeder & Carlson, *supra* note 31, at 536, 551–52. The former conceptualizes *X* and *D* as one and the same legal persons, so that *X*'s

The record supports the trial court[‘s] finding that [X] was personally responsible for many of the unlawful acts and practices of [D Corp.]. [X’s] liability is individual, not joint or cumulative. If a corporate officer participates in the wrongful conduct, or with knowledge approves of the conduct, then the officer, as well as the corporation, is liable for the penalties. Corporate officers cannot use the corporate form to shield themselves from individual liability.¹²⁹

A subsequent Washington case, also cited by Judge Drain,¹³⁰ follows the *Williams* rule in the somewhat different context of a personal cause of action for breach of contract. In *Grayson v. Nordic Construction*,¹³¹ X was the officer and controlling shareholder of D Corp. Plaintiff hired D Corp. to fix the roof of the house she shared with her mother. X made misstatements as to D Corp.’s ability to complete and finance the repairs. The attempt to repair was a complete debacle, leaving the plaintiff worse off than when the project was started. When D Corp. filed for bankruptcy, the plaintiff sued X for breach of contract and violation of the Consumer Protection Act. The trial court found for X on the breach of contract claims on the plaintiff’s piercing/alter ego theory even though it also “found no intentional wrongdoing on the part of” X.¹³² Reading between the lines, unlike the wealthy X in *Williams*, who seems to have been venal, the defendant in *Nordic* seems to have been a hapless and incompetent small-time contractor who got in over his head. Nevertheless, the Washington Supreme Court held that piercing was improper because X had apparently scrupulously respected corporate form. But:

We nonetheless find that personal liability was properly imposed on [X] under the rule enunciated in [*Williams*]. If a corporate officer participates in wrongful conduct or with knowledge approves of the conduct, then the officer, as well as the corporation is liable for penalties. . . . In [*Williams*] this court considered a deceptive practice in violation of the Consumer Protection Act to be type of wrongful conduct which justified imposing personal liability on a participating corporate officer.¹³³

We would note that, in this case, it was X who personally, albeit in his corporate

property would be subject to the claims of D’s creditors. The latter, in contrast, maintains the separate legal personhood of the same parties so that X can only be liable for its own bad actions.

¹²⁹ *State v. Ralph Williams’ N.W. Chrysler Plymouth, Inc.*, 553 P.2d 423, 322 (Wash. 1976) (citations omitted).

¹³⁰ *See In re Purdue Pharma L.P.*, 633 B.R. 53, 108 (Bankr. S.D.N.Y. 2021).

¹³¹ 599 P.2d 1271 (Wash. 1979).

¹³² *Id.* at 1272–73.

¹³³ *Id.* at 1274.

capacity, spoke directly with the plaintiff to relay the promises that *D Corp.* could not fulfill.

In other words, an officer or controlling stockholder violates the Washington Consumer Protection Act if he personally or causes his corporation to engage in the proscribed bad acts. In such a case the claims of the attorney general against *X* would not be derivative of, but in addition to, any claim the attorney general might have against *D Corp.* This means that when the attorney general sues *X*, she is not stepping into *D Corp.*'s shoes. If she were, any recovery would be paid to *D Corp.*¹³⁴ Rather, in *Williams* the attorney general was arguing that *X* individually harmed *D Corp.*'s customers and that the attorney general was bringing personal actions on behalf of *D Corp.*'s customers as Washington citizens. In *Nordic*, the plaintiff was an individual who could recover because *X* individually harmed her.

The fact that *X*'s bad acts (causing *D Corp.* to lie and cheat customers) “overlapped” with *D*'s bad acts, or to put this in the language of plan Section 10.7(b) the “conduct . . . of [*D*] . . . is a legally relevant factor” to *X*'s bad acts, did not keep *X*'s liability from being individual, direct and particularized as opposed to derivative or generalized.¹³⁵ As such, a settlement of a claim a party might have against *D Corp.* under Washington's Consumer Protection Act would not dispose of the separate claim against *X* under the same statute. This would suggest that the Purdue Pharma settlement cannot preclude the City of Seattle's claims against Richard Sackler predicated on his individual liability under Washington law even though those acts “overlapped” with Purdue Pharma's acts. Under Washington law, an officer or controlling stockholder of a corporation who either personally makes statements that violate the law (as in the case of *Nordic*) or causes his corporation to make actionable statements is himself directly and personally — not derivatively — liable.

For example, in *Commonwealth v. Purdue Pharma, L.P.*,¹³⁶ the Attorney General of Massachusetts sued, in addition Purdue Pharma itself, its directors and certain officers for their individual actions in participating in deceptive marketing of opioid products in violation of a Massachusetts statute.¹³⁷ Although this action is

¹³⁴ If *D* were bankrupt, as in the case of *Purdue Pharma*, the recovery would become part of *D*'s estate to be distributed generally to creditors. If *D* were solvent, the recovery would indirectly benefit *D*'s stockholders. Courts will sometimes make an exception to this general rule when, as in *Williams* the defendant is himself a majority stockholder. The court will order that the defendant pay damages to the minority stockholders to avoid the situation where the defendant would, in effect, be paying damages (indirectly) to himself.

¹³⁵ See Twelfth Amended Joint Chapter 11 Plan of Reorganization of Purdue Pharma L.P. and Its Affiliated Debtors, *In re Purdue Pharma, L.P.*, No. 19-23649 (Bankr. S.D.N.Y. Sept. 2, 2021), ECF No. 3726.

¹³⁶ No. 1884-CV-01808, 2019 WL 5617817, at *5 (Mass. Supr. Ct. Oct. 8, 2019).

¹³⁷ According to MASS. GEN. LAWS ANN. ch. 93A, § 4:

Whenever the attorney general has reason to believe that any person is using or is about to use any method, act, or practice declare by section two to be unlawful, and that proceedings would be in the public interest, he may bring an action in the name of the commonwealth against such person to restrain by . . . permanent injunction the use of

listed in the Plan under the term “Pending Opioid Actions” under the literal language of section 10.7 of the plan their individual, as opposed to derivative, liability would not be covered.¹³⁸ These actions have been temporarily stayed in order to facilitate settlement discussions in the chapter 11 case,¹³⁹ but a temporary stay is by no means the same as a release. Once the *Purdue plan* is confirmed and the temporary stay lapses, the Attorney General could have sued the officer on behalf of the *C_v*. As it so happens, however, the Massachusetts Attorney General accepted the settlement and so would be bound by the plan if it is ever confirmed.¹⁴⁰

As we discuss in the next section, in his opinion confirming the *Purdue plan*, Judge Drain read section 10.7 of the plan more broadly than we do. In his view, section 10.7 is not limited to releasing the causes of action owned by *D Corp.* or *T*. It covers claims belonging solely to the *C_v* for wrongful acts committed by *AD* in their individual capacity.

III. JUDGE DRAIN’S OPINION

A. What’s Right About the Opinion

Judge Drain’s opinion in part comports with our view that section 10.7 exculpates *AD* for derivative claims only. He writes: “But obviously not all independent legal claims are properly covered by such a release if based on simply having some relationship to the debtor, a clear example being a third party’s guaranty of a debtor’s obligation.”¹⁴¹ Thus, if *D Corp.* had borrowed funds from a bank and Richard Sackler had guaranteed it, Sackler would not be released. Purdue has no cause of action against Sackler based on Sackler’s hypothetical guaranty of the bank’s loan to Purdue, and the bank would not be stepping into *D Corp.*’s shoes when the bank sues Sackler on the guaranty. The bank’s guaranty cause of action is not released.

such method, act or practice. . . . Said court may . . . make such other orders or judgments as may be necessary to restore any person who has suffered any ascertainable loss by reason of the use or employment of such unlawful method, acts or practice any moneys or property, real or personal, which may have been acquired by means of such method, act, or practice. If the court finds that a person has employed any method, act of practice which he knew or should have known to be in violation of said section two, the court may require such person to pay to the commonwealth civil penalty of not more than five thousand dollars for each such violation and may also require the said person to pay the reasonable costs of investigation and litigation of such violation, including reasonable attorneys’ fees.

MASS. GEN. LAWS ANN. ch. 93A, section 2(a) makes “unfair methods of competition and unfair or deceptive acts of products in the conduct of any trade or commerce” unlawful.

¹³⁸ See *State v. Purdue Pharma L.P.*, C.A. No. PC-2018-4555, 2019 WL 3991963, at *32 (R.I. Super. Aug. 16, 2019); *City of Springfield v. Purdue Pharma, L.P.*, No. 1984-CV-01733, 2020 WL 2254102, at *1 (Mass. Super. Feb. 21, 2020).

¹³⁹ *In re Purdue Pharms. L.P.*, 619 B.R. 38, 62 (S.D.N.Y. 2020) (McMahon, J.).

¹⁴⁰ *In re Purdue Pharma L.P.*, 633 B.R. 53, 87 (Bankr. S.D.N.Y. 2021).

¹⁴¹ *Id.* at 104.

Also, Judge Drain writes:

The Committee also thoroughly investigated the estates' claims against the Sacklers that are not in the nature of avoidable transfer causes of action but, rather, claims based on theories of alter ego, piercing the corporate veil, and breach of fiduciary duty/failure to supervise. Here it appears clear that such claims would belong to the Debtors' estates, not individual creditors, because at least as far as the confirmation hearing record reflects, such claims would be based on a generalized injury to the estates and creditors rather than conduct directed only at certain creditors.

[C]laims based on alter ego, piercing the corporate veil, and breach of fiduciary duty/failure to supervise theories would appear to stem from allegations against Sackler family members that they caused harm to the creditor body generally, or to the Debtors, in exercising their control of the Debtors and, therefore, would belong to the Debtors' estates rather than to individual creditors. As discussed later, very closely related, indeed usually the same, factual allegations also underly the objecting states' third-party claims against Sackler family members.¹⁴²

These passages properly recognize that any theory based on breach of fiduciary duty to *D Corp.* or on piercing the *D Corp.* veil to pursue *AD* belongs to *T*. These claims *T* could settle in a way that binds all the unsecured creditors of *D Corp.* Judge Drain also properly defined what a "derivative claim" is:

"Derivative claims" are widely understood to be claims by a third party that asserts injury to the corporate entity and requests relief that if granted would go to the corporate entity.¹⁴³

The Second Circuit has spent substantial time interpreting what constitutes a true derivative claim, one that, though asserted by a third party, properly belongs to the debtor's estate, as opposed to being recoverable by the third party. In such disputes, the courts generally ask whether the relief sought by the third party would really address only a *secondary harm* to that which flows primarily to the estate.¹⁴⁴

The reference to "secondary harms" bears some comment. In *Marshall v. Picard* (*In*

¹⁴² *Id.* at 87.

¹⁴³ *Id.* at 135 (referencing *Donoghue v. Bulldog Invs. Gen. P'ship*, 696 F.3d 170, 176 (2d Cir. 2012)).

¹⁴⁴ *Id.* (referencing *Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.)*, 855 F.3d 84 (2d Cir. 2017)) (emphasis added); see *Marshall v. Picard (In re Bernard L. Madoff Inv. Secs. LLC)*, 740 F.3d 81 (2d Cir. 2014) (emphasis added).

re *Bernard L. Madoff Investment Securities LLC* (*Madoff I*),¹⁴⁵ *T* successfully settled a fraudulent transfer action against *AD*.¹⁴⁶ *AD* was a “net winner” from the Ponzi scheme. *AD* settled for \$6.7 billion in exchange for a “channeling injunction” prohibiting any *C_g* from bringing a “derivative” claim against *X*.

C_I was also a net winner, but less spectacularly so than *AD*. *C_I*, however, had been cheated by *D Corp.* of paper gains and so sought to recover from *AD* on a tort theory that *AD* knew or should have known of the fraud. *C_I*’s lawsuit was held barred by the channeling injunction. *AD* had not made particularized misrepresentations to *C_I*, as apart from the *C_g* collectively.

C_I claimed unique damages. *C_I* had, for instance, paid taxes on fictitious gains and loss of reasonable return on their investment, plus the expense expected to be incurred when *C_I* were sued by *T* for being net winners, “none of which is recoverable in an avoidance action under the Bankruptcy Code.”¹⁴⁷ The court held that the channeling injunction applied to prevent *C_I* from making tort claims against *AD*. These damages were merely “secondary harms flowing from [*AD*]’s fraudulent withdrawals”¹⁴⁸ As such they could be ignored. The court did not really argue for this result but simply announced it.¹⁴⁹ This is what Judge Drain meant by

¹⁴⁵ 740 F.3d at 81.

¹⁴⁶ The case involved a Ponzi scheme, which are properly constructive trust cases, not fraudulent transfer cases. See David Gray Carlson, *Fraudulent Transfers and Constructive Trusts: When Worlds Collide*, 103 MARQ. L. REV. 365 (2019). *Madoff*, however, is a stockbroker liquidation and therefore governed by the Securities Investors Protection Act (SIPA). In such a case, a victim (*V*) has been fraudulently induced to invest funds with the broker. What *V* entrusted to the broker is “customer property.” 15 U.S.C. § 78(iii)(4) (“The term ‘customer property’ means cash and securities . . . held by or for account of a debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted”). Customer property must be distributed to customers only. See 15 U.S.C. § 78fff-2(c)(1). According to SIPA section 78fff-2(c)(3), however:

Whenever customer property is not sufficient to pay in full the claims set forth in subparagraphs (A) through (D) of paragraph (1) [*i.e.*, customer claims], the trustee may recover any property transferred by the debtor which, except for such transfer, would have been customer property and to the extent that such transfer if voidable or void under [the Bankruptcy Code]. Such recovered property shall be treated as customer property. For purposes of such recovery, the property so transferred shall be deemed to have been the property of the debtor and, if such transfer was made to a customer or for his benefit, such customer shall be deemed to have been a creditor, the laws of any State to the contrary notwithstanding.

15 U.S.C. § 78fff-2(c)(3) (emphasis added). Thus, without SIPA, the *V* would have equitable interests in the broker assets. *V* alone could pursue trust assets that the broker has distributed to third parties. *T* has no theory to pursue *V*’s equitable interest in trust property. But SIPA *deems* the broker to own the equitable interest in customer property, and it authorizes the trustee to recover transfers as if fraudulent transfer really applies, reserving the proceeds for the investors. Therefore, it is appropriate to treat *Madoff* as a fraudulent transfer case.

¹⁴⁷ *In re Madoff*, 740 F.3d at 93.

¹⁴⁸ *Id.*

¹⁴⁹ Aider-abettor liability for fraudulent transfers is a new theory followed only in a minority of states, and it wreaks havoc with the system of avoiding fraudulent transfers in bankruptcy. Suppose it is decided that only a subset of *C_g* can bring tort actions and therefore the trustee is not subrogated to this cause of action. If so, the tort theory profoundly affects *T*’s ability to settle with *X*, the recipient of a fraudulent transfer. If *T*

“secondary harms.” The fraudulent transfer theory belonged to *T* and *C_I* was basically arguing that *AD*’s receipt of the fraudulent transfer caused indirect harm unique to *C_I*.

These parts of Judge Drain’s opinion are unobjectionable. In the above passages he reasoned that *T* had the sole right to settle breach of fiduciary duty, fraudulent transfer and piercing claims, and no *C_I* could gainsay the rightness of the settlement by bringing a subsequent suit against any *AD*.

B. What Is Questionable About the Opinion

The *Purdue plan*, by its terms, bars *C_I* from suing *AD* based on veil piercing, fraudulent transfer and derivative claims based on *AD*’s breach of fiduciary duty against *D Corp.* As such, the third-party release is confirmable as a settlement plan. No theft of *C_V* rights is implied.

Yet Judge Drain read the plan as condoning expropriation of creditor rights against *AD* for acts by *AD* in their individual capacity that were tortious. He reached this conclusion by expanding the definition of “derivative” beyond its proper scope. His reading, though wrong, is sophisticated and challenging. It bears careful analysis.

Judge Drain’s reading is based on the difference between indemnity and direct liability. His reading privileges liability over indemnity. Both of these concepts assume a triangle. In this triangle *AD* owes *D Corp.* because *D Corp.* owes *C_I*.

If *AD*’s duty is merely to indemnify, *AD* owes *D Corp.* if and only if *D Corp.* pays *C_I*. Where *D Corp.* does not and cannot pay *C_I*, *AD* owes nothing. This is actually permitted in maritime insurance. Suppose *AD* writes a policy insuring *D Corp.* from maritime liabilities. Suppose *D Corp.* causes a collision of vessels and owes *C_I*. But *D Corp.* is insolvent and cannot pay *C_I*. The insurance company owes nothing. Meanwhile, solvent *D Corp.* pays a lower premium because *AD* can hide like a coward behind *D Corp.*’s insolvency.

In *Purdue*, Judge Drain’s assumption is that *AD*’s bad acts generated *D Corp.*’s liability to the *C_V* — \$140 trillion worth. Suppose at the time these bad acts commenced, *D Corp.* had a net worth of \$1 billion. Once *D Corp.* paid out the billion, *D Corp.* has been damaged by *AD*’s breach of fiduciary duty. And so *AD* owes *D Corp.* \$1 billion. Under the indemnity concept, \$1 billion is the limit of the damage caused by *AD*. In short, *AD*’s duty under this assumption is to indemnify that which *D Corp.* actually and historically paid out to the *C_V*. As to the remaining \$140 trillion (minus a billion) in claims against *D Corp.*, *D Corp.* could not pay, as its net worth was gone. *D Corp.* was not damaged to the extent *D Corp.* could not pay. *AD*’s liability for a breach of fiduciary duty is limited to the lost net worth when indemnity is the standard.

owns the *in rem* right and the *C_g* own the *in personam* right, *T* cannot guarantee *X* a global settlement. See David Gray Carlson, *Fraudulent Transfer as a Tort*, 2022 MICH. ST. L. REV. (forthcoming 2022).

Indemnity may reign piratically on the high seas, but this is not tolerated by landlubbers. By legislation, insurance companies are obliged to pay *D Corp.* the amount of *C_I*'s claim (up to the policy limit), even where *D Corp.* is insolvent.¹⁵⁰

Indemnity is a shocking concept. Suppose an *AD* personally injures some insolvent *D*. Can *AD* claim that *D* was not really injured because *D* had no net worth? Such a concept suggests that insolvent debtors are incapable of being injured. They are not really "persons" with rights at all — once their net worth is gone!

So, back to *Purdue*, *AD*'s liability to *D Corp.* is not for \$1 billion. The theory is not *indemnity*. The theory is *liability*. *AD* owes *D Corp.* \$140 trillion because *D Corp.* owes the *C_v* \$140 trillion.

Here is the key move made by Judge Drain. *D Corp.* is trying to collect \$140 trillion from *AD* for the benefit of the *C_v*. Thus, *AD*'s liability for breach of fiduciary duty is *precisely like insurance*. Any given *C_I* has a derivative right against *AD* and is represented by *T* in liquidating the fiduciary receivable.

Thus, when *T*, successor to *D Corp.*, collects the fiduciary receivable from *AD*, *T* does this for the benefit of *C_I*. *C_I* cannot opt out of this representation, just as the *C_v* could not opt out in *Manville*.

In pursuing the fiduciary receivable, *T* has settled with *AD*. This settlement binds every *C_g*. On this view of the matter, if a given *C_I* bolts from the settlement and sues *AD* in state court after the plan is confirmed, *C_I* is making a direct attack on property of the bankruptcy estate. *T* succeeds to *D Corp.*'s "fiduciary receivable" and *T* alone has the right to collect it. *C_I*'s claim against *D Corp.* is part of that receivable. By bringing the claim against *AD* directly, *C_I* is diminishing *D Corp.*'s right of recovery against *AD*.¹⁵¹

This, we think, is Judge Drain's theory. It is revealed by Judge Drain's use of the term "overlap":

To properly be subject to a third-party claims release under a plan, therefore, the third-party claim should be premised as a legal matter on a meaningful overlap with the debtor's conduct. Otherwise, the release would be too broad and would cover, for example, a claim

¹⁵⁰ 11 U.S.C. § 109 (2018).

¹⁵¹ Relevant here is a dictum from *Callaway v. Benton*, 336 U.S. 132 (1949), a case hostile to assertion of bankruptcy jurisdiction over third-party property. See Ralph Brubaker, *Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten Callaway v. Benton Case*, 72 AM. BANKR. L.J. 1 (1998). According to the *Callaway* court:

The bankruptcy power unquestionably gives the . . . court, working within the framework of the [Bankruptcy] Act, full and complete power not only over the debtor and its property, but also, as a corollary, over any rights that may be asserted against it [*i.e.*, against the debtor's property].

Callaway, 336 U.S. at 147. In other words, because *C_I* attacks *D Corp.*'s property when *C_I* sues *AD*, the bankruptcy court has power to intervene.

against one of the Sacklers, some of whom are doctors, for negligently prescribing OxyContin to a patient. On the other hand, given a causal legal dependence on the Debtor's conduct, or a legally meaningful relationship with the debtor's conduct, a third-party claim is sufficiently close to the claims against the debtor to be subject to settlement under the debtor's plan if enough other considerations support the settlement.¹⁵²

[T]he third-party claims being released under the settlement are based on essentially the same facts as the Debtors' . . . breach of fiduciary duty/failure to supervise claims.¹⁵³

In his opinion, Judge Drain purports to modify the proposed plan:

I will require section 10.7(b) of the plan, which provides for the release of third-party claims against the shareholder released parties, to be further modified to state that a Debtor's conduct, or a claim asserted against the Debtor, must be a legal cause of the released claim, or a legally relevant factor to the third-party cause of action against the shareholder released party, for the third-party claim to be subject to the release.¹⁵⁴

In relevant part, Judge Drain conceives *AD* to be released if *AD*'s liability arises from *C_I*'s claim against *D Corp.* *D Corp.*'s liability to *C_I* is the stuff of *D Corp.*'s breach of fiduciary duty action against *AD*.

The problem with this view is that *C_v*'s claim against *AD* does not arise because *AD* breached a fiduciary duty to *D Corp.* The *C_v* claims arose because of the breach by *AD* (acting in their individual capacity and not merely as officers of *D Corp.*) of tort duties owed directly to the *C_v*.¹⁵⁵ Admittedly there is an overlap. Admittedly, if

¹⁵² *In re Purdue Pharma L.P.*, 633 B.R. 53, 105 (Bankr. S.D.N.Y. 2021).

¹⁵³ *Id.* at 108.

¹⁵⁴ *Id.* at 105.

¹⁵⁵ Professor Brubaker has remarked:

The channeling rationale, however, cannot be used to justify injunctions that would forever bar an action against a nondebtor based on the nondebtor's personal liability to creditors — in personam actions that in no way encroach upon the bankruptcy court's exclusive in rem jurisdiction over the debtor's property. . . . Applying the channeling rationale to such an injunction takes a mechanism designed to preserve, consolidate, and resolve all in rem claims and transforms it into a mechanism that forcibly converts creditors' in personam claims against a debtor into in rem claims against the debtor's property. In the process, those in personam rights against the nondebtor are extinguished, without any assurance that the substituted in rem rights against the debtor's property are the equivalent of the extinguished in personam rights. Such a drastic alteration of in personam claims against a nondebtor, in the guise of merely protecting the bankruptcy court's exclusive in rem jurisdiction over the debtor's property, is not a proper exercise of traditional in rem channeling powers.

C_v recovers from AD , $D Corp.$'s fiduciary receivable is reduced. C_v is taking property of the estate away from T . But, separately, C_v has direct, nonderivative rights against AD . "Overlap" is Judge Drain's way of saying that the bankruptcy estate has expropriated the property rights of the C_v , which T purports to exercise on behalf of the C_v over their opposition.

Judge Drain's definition of "derivative," therefore, is too broad. His definition encompasses claims belonging to C_l that $D Corp.$ could never have brought against the AD . Judge Drain thus includes within "derivative claim" any claim in which C_l 's claim against AD "overlaps" with C_l 's claim against the Purdue debtors. Judge Drain shows awareness that he is transcending the bounds of derivativity:

If, in fact, those types of [properly derivative] claims were the only claims to be released, we would not be talking about a "third-party claims" release of the shareholder released parties. We would be talking about a release that clarifies and protects the estates from backdoor attacks through the assertion of purported third-party claims, that, in fact, are estate claims to be shared ratably with the estate's creditors.¹⁵⁶

Thus, section 10.7 does not *just* release the AD from claims that $D Corp.$ or T owns. It releases claims that are "sufficiently close"¹⁵⁷ to such claims. That is, it releases claims that $D Corp.$ *does not own*.

From Judge Drain's perspective, overlap distinguishes AD 's liability on a standard guaranty. In *Purdue*, $D Corp.$'s acts at the direction of AD cause harm to C_l , and this harm is the guts of $D Corp.$'s breach of fiduciary duty claim against AD . But in the case of a standard guaranty, $D Corp.$'s acts (breach of contract) give rise to C_l 's claim, but $D Corp.$ cannot sue AD because $D Corp.$ breached the contract with C_l . Therefore C_l 's suit against AD on the guaranty does not tread upon property of the bankruptcy estate. In *Purdue*, C_l 's claim against AD (based on AD 's joint and several liability with $D Corp.$) *did* reduce T 's cause of action against AD for breach of fiduciary duty owing to $D Corp.$

Properly, derivative claims against AD belong to T and not to the C_v . The plan settles these claims and does not permit any C_l to opt out. But the plan as interpreted by Judge Drain expropriates the right of creditors to sue AD — rights that do not belong to $D Corp.$ If the plan means what Judge Drain thinks it does, the plan should not have been confirmed. It is a theft plan.

An analogy to partnership bankruptcies backs this intuition up. Few use the partnership form anymore, given the limited liability company, or if one uses the

Ralph Brubaker, *Supreme Court Validates "Clarified" Manville Insurance Injunction: Channeling . . . and So Much More!*, 29 No. 8 BANKR. L. LETTER, at 3–4 (Aug. 2009) [hereinafter Brubaker, *Clarified*].

¹⁵⁶ *Id.* at 104.

¹⁵⁷ *Id.* at 105.

limited partnership form (requiring there to be at least one general partner), the general partner is an LLC with no assets. Partnership bankruptcies are passing from the scene.

Be that as it may, partnership bankruptcies are governed by Bankruptcy Code section 723(a):

If there is a deficiency of property of the estate to pay in full all claims which are allowed in a case under this chapter concerning a partnership and with respect to which a general partner of the partnership is personally liable, the trustee shall have a claim against such general partner to the extent that under applicable nonbankruptcy law such general partner is personally liable for such deficiency.¹⁵⁸

Thus, T in a partnership case has a chose in action against the partners measured by the aggregate of unsecured claims of all the C_g of the partnership. Suppose A and B are partners and the partnership is bankrupt. If C_l were to bring an action against B and recover, the trustee's chose in action would be diminished. The $C_g \setminus C_l$ would face a reduced dividend, and C_l would unfairly recover in full. Yet the automatic stay does not prevent C_l from pursuing B in competition with the partnership's trustee.¹⁵⁹ Therefore C_l intrudes on property of the bankruptcy estate when C_l bolts from the herd and seeks a full recovery from B. Yet C_l is invited to do so. This result in partnership cases leads us to believe that overlap between T 's claim against AD and C_l 's right against AD does not justify release of AD from C_l 's claim.

IV. ON APPEAL

Just before Christmas, 2021, Judge McMahon reversed Judge Drain's confirmation order. She assumed the plan meant what Judge Drain thought it meant. She took it as a theft plan, and as such the plan was unconfirmable.

While correct on the merits (if the plan means what Judge Drain said it meant), Judge McMahon's opinion is not always conceptually sound. In particular, she is in danger of throwing out several babies with the bath water. Many so-called releases are well-grounded in the Bankruptcy Code. But Judge McMahon writes as if all releases must rise and fall together. We have seen, however, that channeling injunctions in aid of settlement of a chose in action belonging to T merely expresses the concept of *res judicata*, with the proviso that the bankruptcy court keeps exclusive jurisdiction over the scope of what *res judicata* entails. Other releases express the concept that those who in good faith participate in bankruptcy

¹⁵⁸ 11 U.S.C. § 723(a) (2018).

¹⁵⁹ 1 FRANK R. KENNEDY, VERN COUNTRYMAN, & JACK F. WILLIAMS, KENNEDY, COUNTRYMAN & WILLIAMS ON PARTNERSHIPS, LIMITED LIABILITY ENTITIES AND S CORPORATIONS IN BANKRUPTCY § 7.03, at 7–16 (Aspen Publishers, Inc.) (2000).

proceedings are entitled to qualified immunity from claims that their actions (approved by a bankruptcy court) negligently brought about collateral harms to creditors and others. Still others facilitate the liquidation of insurance policies, which are property of the estate as encumbered by the direct action rights of the C_v .

Judge McMahon should have narrowed the inquiry. The only question on the table is: May theft plans be confirmed?

We divide our critique of Judge McMahon's opinion into three parts. First, does a bankruptcy court have residual equitable power to protect AD from C_I 's lawsuit. We argue that, where this relief can be grounded in a traditional doctrine of equity, relief can indeed be extended, according to Supreme Court precedent. Judge McMahon disagrees, however.

Second, since the Supreme Court has followed the French instinct that whatever is not prohibited is permitted, one must locate some concrete part of the Bankruptcy Code that fairly prohibits theft plans. We have located that prohibition in Bankruptcy Code section 1129(a)(3): The plan must not use "any means forbidden by law."¹⁶⁰ We think that this commands: Thou shalt not steal. Judge McMahon, in contrast, takes the Prussian attitude that what is not permitted is forbidden. Nevertheless, she does offer three specific moments in the Bankruptcy Code that supposedly imply prohibition separate and apart from a Prussian substrate. We criticize all three of these propositions.

Finally, Judge McMahon works hard to steer the vessel through the shoals and reefs of Second Circuit precedent. She basically does so, but the vessel does not emerge from the voyage entirely unscathed. The Second Circuit precedents are indeed troubling.

A. Residual Equitable Powers

In confirming the plan, Judge Drain wrote: "I firmly believe that . . . there is a sufficient source of power in the Bankruptcy Code itself, in sections 105(a) and 1123(a)(5) and (b)(6), as well as in the Court's inherent equitable power"¹⁶¹ to justify section 10.7 of the plan. Section 1123(a)(5) commands that the plan provide for its own implementation, while section 1123(b)(6) is the French provision that invites any plan term that is not inconsistent with the Bankruptcy Code. Arguably section 105(a) is at the heart of this justification. According to section 105(a), "[t]he court may issue any order . . . that is necessary or appropriate to carry out the provisions of this title."¹⁶²

Judge McMahon, however, took the strong position that section 105(a) justifies equitable relief only in conjunction with some *other* express provision of the Bankruptcy Code. (We nickname this proposition as the "rule of conjunction"). And since no other provision of the Bankruptcy Code authorizes third-party releases,

¹⁶⁰ See *supra* text accompanying note 82.

¹⁶¹ *In re Purdue Pharma*, 633 B.R. at 105.

¹⁶² 11 U.S.C. § 105(a) (2018).

section 105(a) does not serve to justify confirmation of the *Purdue plan*. Rather, the Prussian substrate prohibits the release because no Bankruptcy Code provision authorizes it.

We think that taken on its own, this “rule of conjunction” is unfortunate. It should be possible for a bankruptcy court to pursue some traditional equitable goal, even if the equitable goal is not expressly set forth in the Bankruptcy Code. The Supreme Court has expressly said so: “[T]he Bankruptcy Code incorporates traditional equitable principles.”¹⁶³

For the “rule of conjunction,” Judge McMahon heavily relied upon the egregious case of *New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (In re Dairy Mart Convenience Stores, Inc.)*.¹⁶⁴ Merely reciting the facts of that case serves to refute the rule of conjunction.

In *Dairy Mart*, *C₁* sued *D Corp.* for breach of contract and sought a pre-judgment attachment of assets. In lieu of a bond, which would have suspended the attachment, the trial court gave *D Corp.* the option of obtaining for *C₁*’s benefit a letter of credit from a bank securing *D Corp.*’s payment of any eventual judgment. The letter of credit that *D Corp.* provided, however, had an expiry of one year. *C₁* protested to the trial court that the short life span of the letter of credit was unfair. It protested that *D Corp.* should procure a revised letter of credit that would permit draw-down if *D Corp.* failed to renew it or if *D Corp.* filed for bankruptcy. The trial court denied this requested order and instead ordered *D Corp.* to renew the letter of credit 60 days before its expiration. Presumably *D Corp.*’s obligation to reimburse the bank in case *C₁* drew down the letter of credit was secured by assets of *D Corp.*¹⁶⁵

D Corp. filed for bankruptcy and, as a debtor-in-possession, it gleefully declined to provide for a new letter of credit. This had the effect of denying *C₁* its security and disencumbering *D Corp.*’s assets from the bank’s presumed secured right to be reimbursed. *C₁* requested an order compelling *D Corp.* to restore the letter of credit. The bankruptcy court denied the order. *C₁* filed for an emergency order with the district court and the district court refused relief. *C₁* appealed to the Second Circuit. A day before the letter of credit lapsed, the trial court issued judgment against *D Corp.* (in apparent violation of the automatic stay). *C₁* failed to draw down the letter of credit in time. The letter of credit lapsed.

On appeal, *C₁* claimed that its right to adequate protection was violated, but the Second Circuit ruled that *C₁* had no security interest on the assets of *D Corp.* The Second Circuit laughed at *C₁* for “acquiescing” to a temporary letter of credit from *D Corp.* in lieu of a bond.¹⁶⁶ *C₁* was out \$2.75 million.¹⁶⁷

¹⁶³ *Young v. United States*, 535 U.S. 43, 53 (2002).

¹⁶⁴ *See* 351 F.3d 86 (2d Cir. 2003).

¹⁶⁵ This is certainly to be expected. David Gray Carlson & William H. Widen, *Letters of Credit, Voidable Preferences, and the “Independence” Principle*, 54 BUS. LAW. 1661, 1662 (1999).

¹⁶⁶ *In re Dairy Mart Convenience Stores, Inc.* 351 F.3d 86, 91 (2d Cir. 2003) (“[*C₁*] acquiesced in (or insufficiently protested) [*D Corp.*’s] satisfaction of [pre-judgment attachment] by procuring a letter of credit, and did not insist that [*D Corp.*] provide security in the form of a direct property interest.”).

As for Bankruptcy Code section 105(a), the *Dairy Mart* court remarked that this section “must and can only be exercised within the confines of the Bankruptcy Code.”¹⁶⁸ “It does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law or constitute a roving commission to do equity.”¹⁶⁹

The case is a dark travesty, and the Second Circuit should hang its Cerberus heads in shame. *D Corp.* was unjustly enriched by violating a court order. Surely section 105(a) would have supported preventing bankrupt debtors-in-possession from enriching the bankruptcy estate through the flouting of a pre-petition court order.

Traditional equitable principles were on display in *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*,¹⁷⁰ where the court invoked marshaling of assets as grounds to issue an injunction achieving a third-party release. Marshaling of assets is a traditional equity instinct that grounded the section 105(a) order, even though no bankruptcy provision authorizes a bankruptcy court to marshal assets. At least in the case of an eminent domain plan, the general equity powers of a bankruptcy court should justify the channeling injunction in a chapter 11 plan.

As an example of the harm done to bankruptcy jurisdiction where the rule of conjunction bars equity in general, we have seen¹⁷¹ that, in *Landsing Diversified Properties II v. First National Bank & Trust Co. (In re Western Real Estate Fund, Inc.)*,¹⁷² the Fifth Circuit struck down an injunction that prevented an attorney from suing *AD* for a legal fee above and beyond the reasonable fee the bankruptcy court was (on remand) to determine. No section of the Bankruptcy Code prohibits third parties from unjustly enriching themselves by second-guessing a bankruptcy court determination of a reasonable legal fee under section 502(a)(4). Yet such an injunction should have been permitted under section 105(a) nevertheless. Otherwise, section 502(a)(4) would be undercut and an attorney seeking unreasonable fees would be unjustly enriched. The Bankruptcy Code never says, “attorneys may not unjustly enrich themselves.” Yet the equitable principle barring unjust enrichment should be viewed as built into the Bankruptcy Code.

Dairy Mart’s stingy interpretation of Bankruptcy Code section 105(a) conflicts with *Young v. United States*,¹⁷³ which authorized a declaratory judgment by a bankruptcy court within the purview of section 105(a). *Young* concerned discharge of a tax debt. Under the rules, a “stale” tax debt (over three years since its assessment) is dischargeable, even though fresh tax claims are not.¹⁷⁴ In *Young*, the

¹⁶⁷ *Id.* at 92 (finding *C₁* assumed the risk that *D Corp.* could evade a court order by filing for bankruptcy).

¹⁶⁸ *Id.* (quoting *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)) (citation omitted).

¹⁶⁹ *Id.* (quoting *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986)).

¹⁷⁰ 880 F.2d 694 (4th Cir. 1989).

¹⁷¹ See *supra* text accompanying note 163.

¹⁷² 922 F.2d 592 (10th Cir. 1990), *modified on other grounds sub nom. Abel v. West*, 932 F.2d 898 (10th Cir. 1991).

¹⁷³ 535 U.S. 43 (2002).

¹⁷⁴ See 11 U.S.C. § 523(a)(1) (2018).

relevant timeline was:

January 3, 1994:	Tax assessed.
May 1, 1996:	<i>D</i> files in chapter 13.
January 3, 1997:	The tax debt became stale.
March 12, 1997:	<i>D</i> files in chapter 7.
March 13, 1997:	The earlier chapter 13 case was dismissed.
June 17, 1997:	The chapter 7 discharge granted. Case closed.

Even though the three-year look-back period had lapsed, the IRS demanded payment after the chapter 7 case closed. *D* re-opened the bankruptcy case in order to obtain a declaration that the tax debt was discharged and that the IRS had violated the discharge injunction.¹⁷⁵ In the bankruptcy court and all levels of appeals, the courts ruled against declaratory relief for *D*. Although the plain meaning of the Bankruptcy Code was a three-year lookback, the Supreme Court ruled that bankruptcy courts had access to traditional equitable doctrines for extending statutes of limitations:

It is hornbook law that limitations periods are “customarily subject to ‘equitable tolling’” . . . Congress must be presumed to draft limitations periods in light of this background principle. That is doubly true when it is enacting limitations periods to be applied by bankruptcy courts, which are courts of equity and “appl[y] the principles and rules of equity jurisprudence.”¹⁷⁶

This case proves that section 105(a) orders can be sustained on the basis of equity jurisdiction not specifically grounded in a section of the Bankruptcy Code.¹⁷⁷ And,

¹⁷⁵ See *id.* § 524(a)(2).

¹⁷⁶ *Young*, 535 U.S. at 49–50 (citations omitted).

¹⁷⁷ In her opinion, Judge McMahon accused the Fourth and Eleventh Circuit of ruling that third-party releases are permissible by section 105(a) alone. This may, however, be doubted. No one seriously believes that, in the absence of compensation, section 105(a) authorizes a court to release a claim against a non-debtor owned by a creditor in the bankruptcy.

In *National Heritage Foundation, Inc. v. Highbourne Foundation*, 760 F.3d 344 (4th Cir. 2014), *cert. denied*, 574 U.S. 1076 (2015), the Fourth Circuit upheld the lower courts that refused to confirm a plan containing third-party releases. In so ruling, the Fourth Circuit does no more than cite its previous *Robins* opinion with the observation, “[b]ut the power to authorize non-debtor releases is rooted in a bankruptcy court’s equitable authority.” *Highbourne*, 760 F.3d at 350. We have seen that *Robins* is almost entirely a class action case, not a bankruptcy case, except with regard to a small opt-out group of creditors with flaky third-party claims. The court invoked marshaling assets and concluded that, since the opt-outs could opt back in and be paid in full (for the appraised value of their claim), the plan could enjoin suits against officers and directors. So viewed, the case does not authorize theft via a channeling injunction where compensation in full is not promised. See *supra* text accompanying notes 95–112.

SE Property Holdings, LLC v. Seaside Engineering & Surveying, Inc. (In re Seaside Engineering & Surveying, Inc.), 780 F.3d 1070 (11th Cir. 2015), was a case in which the court upheld a qualified immunity release. Qualified immunity arises from court supervision of every step of the bankruptcy proceeding and so it is unfair to say that this case held that the release emanated from section 105(a) alone. It emanated from

therefore, the egregious *Dairy Mart* case contradicts a governing Supreme Court precedent.

But this does not answer the question whether section 105(a) authorizes section 10.7 of the *Purdue plan*. Where the Bankruptcy Code *prohibits* third-party releases, section 105(a) cannot justify overriding the Bankruptcy Code.¹⁷⁸

B. Inconsistencies between the Bankruptcy Code and Third-party Releases

Much of Judge McMahon's opinion depends on the Prussian maxim that what is not expressly permitted is prohibited. But, as we have seen, this flies in the face of *United States v. Energy Resources*,¹⁷⁹ — which read Bankruptcy Code section 1123(b)(6) (a plan may “include any other appropriate provision not inconsistent with the applicable provisions of this title”)¹⁸⁰ in the French fashion — what is not prohibited is permitted.

If this is a fair reading of *Energy Resources*, then the challenge is to locate some provision in the Bankruptcy Code that actually does prohibit theft of *C_I*'s cause of action against *AD* for *AD*'s tortious actions. The Bankruptcy Code does say that a chapter 11 plan must not propose “any means forbidden by law.”¹⁸¹ This was the hook upon which we hung the proposition that a plan may not impose uncompensated theft of *C_I* rights against *AD*.¹⁸²

This thought does not expressly appear in Judge McMahon's opinion.¹⁸³ Instead, Judge McMahon locates specific prohibitions in (1) section 524(g) (which ostensibly cover asbestos cases), (2) section 523(a) (governing discharges of bankrupt debtors) and section 1141(d) (governing nondischargeability of certain claims) and (3) “possibly even with section 524(e)” (providing the discharge of a debtor “does not affect the liability of any other entity on . . . such debt”).¹⁸⁴

Each of these points can be questioned.

1. The Asbestos Provision

Purdue is no asbestos case and section 524(g) does not apply. Nevertheless,

the many provisions of the Bankruptcy Code governing sales, lending and confirmation, which put professionals under close judicial scrutiny.

¹⁷⁸ See *Law v. Siegel*, 571 U.S. 415, 421 (2014) (“It is hornbook law that § 105(a) ‘does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code.’”) (citation omitted).

¹⁷⁹ 495 U.S. 545 (1990).

¹⁸⁰ 11 U.S.C. § 1123(b)(6) (2018).

¹⁸¹ *Id.* § 1129(a)(3).

¹⁸² See *supra* text accompanying notes 76–85.

¹⁸³ She does mention an anti-theft spirit in connection with section 1123(a)(5), which requires a plan to provide for its own implementation. See *In re Purdue Pharma L.P.*, 633 B.R. 53, 103 (Bankr. S.D.N.Y. 2021) (“This statutory scheme reflects Congress’s exercise of its preemption powers, which permit the abolition of [rights] to attain a permissible legislative object.”) (alteration in original).

¹⁸⁴ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 114 (S.D.N.Y. 2021).

Judge McMahon reasoned that Congress passed judgment on theft plans when it permitted theft in asbestos cases but not elsewhere. The negative pregnant implication of section 524(g) is that theft plans outside the context of asbestos are not permitted.¹⁸⁵

In truth, Congress has never said anything directly about theft plans — even in section 524(g). Section 524(g) permits channeling injunctions in the case of derivative actions belonging solely to *T*.¹⁸⁶ It does not expropriate *C_v* rights against tortfeasors. In any case, Congress enacted the following statement about section 524(g), which was never codified in the Bankruptcy Code:

RULE OF CONSTRUCTION — Nothing in subsection (a) [*i.e.*, Bankruptcy Code section 524(g)], or in the amendments made by subsection (a), shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization.¹⁸⁷

Here, Congress expressly denies any negative pregnant implication.

In arguing that, since Congress knew how to permit asbestos theft, it therefore intended to prohibit non-asbestos theft, Judge McMahon once again runs counter to *Young v. United States*,¹⁸⁸ where, it will be recalled,¹⁸⁹ the Supreme Court ruled that equitable tolling is built into every statute of limitations in the Bankruptcy Code.

In *Young*, *D* had attempted a “knew how to” argument structurally similar to the one that Judge McMahon articulated. *D* argued that Congress knew how to write tolling into the Bankruptcy Code in specific instances — to wit, section 108(c)(2).¹⁹⁰ Said the *Young* court:

¹⁸⁵ *Id.* at 111 (“So the silence that speaks volumes is not Congress’ failure to say, ‘And you can’t give involuntary non-debtor releases to anyone except in an asbestos case.’ The silence that speaks volumes is the twenty-seven years of unbroken silence that have passed since Congress said, ‘We are limiting this to asbestos for now, and maybe, when we see how it works in that context, we will extend it later.’”).

¹⁸⁶ See *supra* text accompanying notes 65–74.

¹⁸⁷ Bankruptcy Reform Act of 1994; see Meltzer, *supra* note 92, at 31–32.

¹⁸⁸ 535 U.S. 43 (2002).

¹⁸⁹ See *supra* text accompanying notes 173–78.

¹⁹⁰ According to Bankruptcy Code section 108(c):

[I]f applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of —

- (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
- (2) 30 days after notice of the termination or expiration of the stay under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

[W]e would draw no negative inference from the presence of an express tolling provision in § 108(c)(1) [sic: Should be § 108(c)(2)] and the absence of one in § 507.¹⁹¹ It would be quite reasonable for Congress to instruct nonbankruptcy courts (including state courts) to toll *nonbankruptcy* limitations periods (including state-law limitations) while, at the same time, assuming that bankruptcy courts will use their inherent equitable powers to toll the federal limitations periods within the Code.¹⁹²

Therefore, a “knew how to” argument is not binding where it seems reasonable for Congress to intervene *here* without intending the opposite result *there*.

We think the argument from section 524(g) is exceptionally weak. Congress did not authorize theft plans at all. It therefore did not know how to condone theft *here* but not anywhere else. All we know is that Congress *didn’t* know how to condone theft in asbestos cases.

2. Discharge

Judge McMahon locates a second anti-release implication from the fact that, in *Purdue*, *AD* would receive a discharge from what arguably could be viewed as civil penalties owing to governmental units. Section 523(a)(7) prohibits a *debtor’s* discharge from debt “for a fine, penalty, or forfeiture payable to . . . a governmental unit” If the *debtor* cannot get a discharge from a civil penalty, then it must be true that *AD* cannot get one either.¹⁹³

This argument, however, proves too much. It tends to eliminate the possibility of channeling injunction to protect *AD* in a fraudulent transfer claim. The Supreme Court has ruled that recipients of intentionally fraudulent transfers are unworthy of bankruptcy discharge under section 523(a)(2).¹⁹⁴ Yet surely, where *T* sues *AD* for

¹⁹¹ The three-year lookback provision applicable to the IRS appears in section 507(a)(8)(A)(i).

¹⁹² See *Young*, 535 U.S. at 52 (emphasis in original). *D* made a similar “knew-how-to” contrast between tolling in section 507(8)(A)(ii) and no tolling in section 507(8)(A)(I). This too was rejected:

If anything, § 507(8)(A)(ii) demonstrates that the Bankruptcy Code incorporates traditional equitable principles. An “offer in compromise” is a settlement offer submitted by a debtor. When § 507(8)(A)(ii) was enacted, it was IRS practice — though no statutory provision required it — to stay collection efforts (if the Government’s interests would not be jeopardized) during the pendency of an “offer of compromise.” Thus, a court would not have equitably tolled the 240-day lookback period during the pendency of an “offer of compromise” since tolling is inappropriate when a claimant has voluntarily chosen not to protect his rights within the limitations period. Hence the tolling provision in § 507(a)(8)(A)(ii) supplements rather than displaces principles of equitable tolling.

Id. at 53.

¹⁹³ See *In re Purdue Pharma, L.P.*, 635 B.R. 26, 107 (S.D.N.Y. 2021) (“At least some of the claims asserted by the State Appellants seek relief in the nature of non-dischargeable civil penalties payable to and for the benefit of governmental units.”).

¹⁹⁴ See *Husky Int’l Elecs., Inc. v. Ritz*, 578 U.S. 355, 357 (2016).

fraudulent transfer, *T* has the right to settle that claim. This settlement is binding on all the *C_g*, and the bankruptcy court may protect the settlement with a channeling injunction. Indeed, the Sacklers were sued for receipt of intentional fraudulent transfers. If they were in bankruptcy, they could not receive a discharge from such a claim. Yet surely *T* can settle the fraudulent transfer claims and back the settlement with a channeling injunction that replicates the effect of *res judicata*.

In *Marshall v. Picard (In re Bernard L. Madoff Investment Securities LLC)*,¹⁹⁵ *T* settled a fraudulent transfer claim with *AD*, an individual, and the bankruptcy court protected that settlement with a channeling injunction. In *Madoff*, *AD* was an individual who, if bankrupt, would probably be entitled to a discharge, as *AD* seems not to have knowledge that the dividend it received was a fraudulent transfer.¹⁹⁶ But surely the channeling injunction should not turn on whether *AD* had guilty knowledge of the fraudulent transfer. The channeling injunction is appropriate in any case where *T* settles a fraudulent transfer claim.

In *Tronox Inc. v. Kerr-McGee Corp. (In re Tronox Inc.)*,¹⁹⁷ the Second Circuit upheld a channeling injunction in favor of *AD*, who was accused of receiving a fraudulent transfer. Granted, *AD* was a corporation, and corporations in chapter 11 can be discharged from claims described in section 523(a),¹⁹⁸ provided the chapter 11 plan does not culminate in liquidation.¹⁹⁹ But surely the *Tronox* court was upholding a channeling injunction in all fraudulent transfer cases, not just cases where *AD* happens to be a corporation.

Because Judge McMahon's inference from section 523(a) (discharge) disenfranchises the channeling injunction in fraudulent transfer cases, the inference must be rejected. Confirmability is possible where *T* is settling a cause of action that belongs to *T* alone.

3. Section 524(e)

Some courts hold that third-party releases are expressly prohibited by Bankruptcy Code section 524(e), which provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."²⁰⁰ Several

¹⁹⁵ 740 F.3d 81 (2d Cir. 2014).

¹⁹⁶ See *Sauer Inc v. Lawson (In re Lawson)*, 791 F.3d 214, 220 (1st Cir. 2015), *cert. denied*, 578 U.S. 1002 (2016) ("[T]he debtor-transferee must herself be 'guilty of intent to defraud' and not merely be the passive recipient of a fraudulent conveyance. . . . Such intent may be inferred from her acceptance of a transfer that she knew was made for the purpose of hindering the transferor's creditor(s), but it may not be implied as a matter of law.") (citation omitted).

¹⁹⁷ 855 F.3d 84 (2d Cir. 2017).

¹⁹⁸ Compare 11 U.S.C. § 1141(d)(1)(A) (2018), with 11 U.S.C. § 1141(d)(2) ("A discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 . . .").

¹⁹⁹ See 11 U.S.C. § 1141(d)(3).

²⁰⁰ Section 524(a)(3) establishes a permanent injunction against collecting a discharge. Basically, this covers collecting from *D*, but it also protects *D*'s spouse in community property states, where a discharged

circuit court opinions have barred *any* release of a third party on grounds of Bankruptcy Code section 524(e).²⁰¹ At least in some of these cases, the release was in any case too broad and should have been denied without any reference of section 524(e).²⁰² In *Bank of New York Trust Co., N.A. v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.)*,²⁰³ however, the court ruled that a qualified immunity injunction could not be issued to protect the buyers of assets under the plan, because section 524(e) implied that only debtors could be released.²⁰⁴ Yet members of the creditors' committee could be protected because they were disinterested,²⁰⁵ whereas the buyers were selfish. One would think that, if section 524(e) implies that only *debtors* can be discharged, this works against the selfless creditors' committee as well as other selfish participants in the bankruptcy process.²⁰⁶

Basically, Judge McMahon took the Holmesian view that law is a prediction of what the Second Circuit says it is. Accordingly, she predicted that a prohibition of third-party releases by section 524(e) is *possible*.²⁰⁷ But she ultimately rejected the

creditor seeks the spouse's share of the community property.

²⁰¹ See, e.g., *Underhill v. Royal*, 769 F.2d 1426 (9th Cir. 1985).

²⁰² See *Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394 (9th Cir. 1995).

²⁰³ 584 F.3d 229 (5th Cir. 2009).

²⁰⁴ *Id.* at 252 ("We see little equitable about protecting the released non-debtors from negligence suits arising out of the reorganization.").

²⁰⁵ *Id.* at 253 ("The Creditors' Committee and its members are the only disinterested volunteers among the parties sought to be released here.").

²⁰⁶ Professor Ralph Brubaker has dedicated a large part of his career to vigorously opposing third-party releases in chapter 11 plans, but even he disagrees that section 524(e) bars third-party releases:

Although this article contends that a bankruptcy court does, indeed, lack authority to approve a nonconsensual release of creditors' non-debtor claims, courts' and commentators' reliance upon section 524(e) as a statutory prohibition is misguided and unfortunate. Section 524(e) is necessary, as a matter of mere mechanics, to prevent the debtor's discharge from automatically discharging co-debtors and guarantors, through the operation of common-law suretyship rules that release secondary obligors upon release of the primary obligor. Consistent with this limited purpose . . . the literal terms of section 524(e) say only that the debtor's discharge does not, by its own force, affect the liability of others. Nothing in section 524(e) can be read to affirmatively prohibit a bankruptcy court from using its equitable injunctive powers in furtherance of a successful reorganization of the debtor.

Preoccupation with the interpretational debate over section 524(e) has allowed the practice of approving a non-debtor release to take hold, given the absence of any full and meaningful response to the equitable powers argument.

Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Release in Chapter 11 Reorganizations*, 4 U. ILL. L. REV. 959, 971-72 (1997) [hereinafter Brubaker, *Complex Litigation*]; see *In re Heron*, Burchette, Ruchert & Rockwell, 148 B.R. 660, 687 (Bankr. D.D.C. 1992) (Section 524(e) "is merely declarative of the effect of a discharge under § 524. It does not affect the ability of the court to issue a permanent injunction under § 105(a) that affects the liability of a non-debtor on the debtor's debt. Such an injunction exists apart from the discharge under § 524."). But see KENNEDY ET AL., *supra* note 159, § 7.04, at 7-44 ("Section 524(e) appears to speak directly to the issue posed by a release of a nondebtor.").

²⁰⁷ See *In re Heron*, 148 B.R. at 687 ("Section 524(e) contains no language of prohibition and should not

idea that section 524(e) affirmatively prohibits such releases.²⁰⁸ Her rejection of section 524(e) as a prohibitive source contains some contestable premises:

Section 524(e) says, in sum and substance, that releasing a debtor on a debt owed to a creditor does not affect the liability that a non-debtor may have for the same debt. But the claims that would be released by the Section 10.7 Shareholder Release are not claims on which the Sacklers are jointly liable with Purdue. The various state statutes being invoked by Appellants give rise to Sackler liability *independent* of Purdue's liability — albeit for the very same violations of the very same laws — because those laws impose an independent duty on persons who occupy certain managerial positions in a corporation. We would not have this appeal if the Sackler debts being eliminated by the Section 10.7 Shareholder Release were also debts owed by Purdue; we would be back in Section 10.6 land, dealing with derivative claims, where the Bankruptcy Court's power is unchallenged.²⁰⁹

be interpreted to limit the court's power under § 105(a).") (citations omitted).

²⁰⁸ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 108 (S.D.N.Y. 2021) ("I am, therefore, constrained to conclude that the Section 10.7 Shareholder Release is not inconsistent with § 524(e) . . ."). She does note in passing that the asbestos provision allows releases "[n]otwithstanding the provisions of section 524(e)" *In re Purdue Pharma*, 635 B.R. at 95; 11 U.S.C. § 524(g)(4)(A)(ii). "The word 'notwithstanding' suggests that the type of injunction Congress was authorizing in § 524(g) would be barred by § 524(e) in the absence of the statute." *In re Purdue Pharma*, 635 B.R. at 92. But we have expressed doubt that section 524(g) releases particularized creditor rights; we think it is limited strictly to derivative rights. In any case, Judge McMahon subsequently renounces any implication about 524(e) based on 524(g):

However, back when Congress was considering § 524(g), it had before it a specific situation: the claims being released were against non-debtor insurance companies whose liability was premised on the conduct of their insureds that fell within the terms of the policies they had issued. Everything that was being released was part and parcel of the bankruptcy estate; the debts owed by Manville and its insurers were the same debts; § 524(e) was obviously implicated. There is no indication, either in the text of the statute or in the legislative history, that Congress ever envisioned that a bankruptcy court could discharge the debts of non-debtors that were not also debts of the debtor. That being so, I cannot read the "notwithstanding" language to create an inconsistency on the facts of this case.

Id. at 107–08.

²⁰⁹ *Id.* at 107. Judge McMahon finds anything released by section 10.6 of the Plan to be acceptable. Yet section 10.6 is precisely identical to the unacceptable section 10.7. Section 10.6 also releases third parties "Released Parties," which is defined to include "Related Parties." Related Parties are defined to include "past, present and future officers, board members, directors, principals, agents . . . direct or indirect owners and/or equity holders . . ." This might seem to cover the Sacklers, but "Released Parties" excludes "Shareholder Released Party," and this is defined to *exclude* the Sacklers, who are covered, for some reason, by the offending section 10.7. Thus, if Plan section 10.7 is unacceptable, so is section 10.6, to the extent it protects non-Sackler officers from liability for their own acts. We, however, read both section 10.6 and section 10.7 as not including tort claims based upon the tortious acts committed by any third party.

Most people would say, with respect to Washington law, that the Sacklers and Purdue are indeed “jointly liable.” What Judge McMahon perhaps meant to say was that joint liability portends particularized creditor rights. The C_v have a right to sue the Sacklers for tortious acts they committed. These rights cannot be expropriated from the C_v because the Bankruptcy Code does not permit, or perhaps prohibits, it. In any case, we read *both* section 10.6 and 10.7 of the plan as settling T ’s causes of action against the AD . No C_v rights are expropriated.

C. Second Circuit Precedent

The third thing Judge McMahon had to do in her opinion was to navigate the shoals and hidden reefs of Second Circuit precedent, an exceptionally delicate task.

A major precedent obstructing Judge McMahon was *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc.*,²¹⁰ where the bankruptcy court had confirmed a plan that released a lender (who was a former insider of *D Corp.*) and others from liabilities from claims arising out of *any* matter related to *D Corp.* The release covered but also exceeded the qualified immunity emanating from a court-approved transaction in the bankruptcy. Pre-petition liabilities were also covered, and there was no indication that the released creditors would be paid in full under the plan.²¹¹

The Second Circuit questioned whether the Bankruptcy Code authorized such a release. In any case, the *Metromedia* court felt that it could not uphold confirmation. The bankruptcy court did not examine whether the release was “important” to the plan: “The bankruptcy court’s findings were insufficient. 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”²¹²

The *Metromedia* court announced itself reluctant to uphold a third-party release. First, the only bankruptcy provision that allowed releases is the asbestos provision — Bankruptcy Code section 524(g). We have already questioned, however, whether section 524(g) releases extend beyond *D Corp.*’s own claims against *AD* or beyond foreclosure of the successor liability that encumbers factories.²¹³ But, if we are right

²¹⁰ 416 F.3d 136 (2d Cir. 2005).

²¹¹ The *Metromedia* opinion contains a hint that confirmation might have been possible if the plan compensated C_I in full:

[W]e reject appellees’ argument that because [C_I] were allocated a Plan distribution, they received consideration, and therefore cannot be heard to complain about the nondebtor releases. [C_I ’s] Plan distribution . . . was on account of appellants’ Notes, not on account of their claims against any non-debtor. . . . In any event, a nondebtor release is not adequately supported by consideration simply because the nondebtor contributed something to the reorganization and the enjoined creditor took something out.

Id. at 143 (citations omitted). The last sentence hints that, if C_I had received 100 cents on the dollar from the plan, the release *would* be “adequately supported by consideration.” *Id.*

²¹² *Id.*

²¹³ See *supra* text accompanying notes 67–68.

about section 524(g), this only serves to strengthen appellate reluctance to approve third-party releases.

Second, the *Metromedia* court worried, releases are subject to abuse. To be sure, said the *Metromedia* court, releases can be had for a substantial payoff, as occurred in *In re Drexel Burnham Lambert Group*,²¹⁴ a case to which we shall soon turn. But *Drexel* was an “unusual” case: “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”²¹⁵ The lower court had failed to find that the release in *Metromedia* was truly unusual and important to the plan. This language hints that theft plans might indeed be confirmable if the payoff is important to achieving confirmation of the plan.

Ironically, in the end, the *Metromedia* court *did* uphold the release. The case was equitably moot because *AD* paid into the plan and received *D Corp.* securities in exchange. It was too much trouble to unscramble the omelet, and so the third-party release prevailed, though the confirmation order was provisionally proclaimed illegal, for want of findings concerning importance to implementation of the plan.²¹⁶

Significantly, the *Metromedia* court acknowledged the rightness of the earlier precedent, *In re Drexel Burnham Lambert Group*.²¹⁷ *Drexel* was a stockbroker bankruptcy, with a securities class action appended to it. It therefore was not properly a bankruptcy case at all, as Judge McMahon emphasized. The issue in *Drexel* was whether the class representatives could settle the case and bind unhappy clients who were not permitted to opt out of the settlement. The Second Circuit answered in the affirmative. Settlement bound the dissenters.

In *Drexel*, *D Corp.* had agreed to settle an action brought by the Securities and Exchange Commission against it and its officers for the benefit of *C_v*. *D Corp.* paid the first installment but filed for bankruptcy before the remaining two installments could be paid. The SEC and the *C_v* filed proofs of claim in the bankruptcy, but the district court withdrew all the securities claims against *D Corp.* In charge of these claims the district court appointed a committee, which commenced to negotiate a settlement between the *C_v* (on one side) and *D Corp.* and *AD* (on the other side). The settlement created a class of 850 *C_v* in a “mandatory non-opt-out class.”²¹⁸ The settlement was contingent on the confirmation of a chapter 11 plan in the *D Corp.* bankruptcy. A few of the *C_v* objected to the class certification and settlement and took an appeal.

The first issue facing the *Drexel* court was its own jurisdiction to hear the appeal, because the settlement was not exactly final. It was contingent on

²¹⁴ SEC v. Drexel Burnham Lambert Grp. Inc., 960 F.2d 285 (2d Cir. 1992).

²¹⁵ *In re Metromedia Fiber Network Inc.*, 416 F.3d at 143.

²¹⁶ Perhaps influencing that result was that *C_I* was contractually subordinated to a class of senior creditors, who supported the plan and would in any case receive *C_I*’s dividend under the plan. But presumably *C_I* would receive 100% on the dollar from *AD*, since *C_I*’s right against *AD* was *dehors* the subordination agreement.

²¹⁷ See *In re Drexel Burnham Lambert Grp. Inc.*, 960 F.2d at 293.

²¹⁸ See *id.* at 288.

confirmation of a chapter 11 plan in *D Corp.*'s bankruptcy case. Bankruptcy appeals, however, have a looser standard of finality. The Second Circuit applied the looser standard, even though the class action was a case merely "related to" a bankruptcy case and was not within the bankruptcy proceeding as such.

In deciding there was jurisdiction for the appeal, the Second Circuit ruled that the *C_v* were 100% paid by the settlement fund largely funded by non-debtor officers of *D Corp.* Therefore, *Drexel* has to be considered as dealing with an eminent domain situation. In any case, the rights of the *C_v* to sue *D Corp.*'s officers were not taken away by a chapter 11 plan. They were taken away by force of the non-opt-out class action. For that reason, *Drexel* should not be considered a bankruptcy case at all.

On the merits, the *Drexel* court ruled that the non-opt-out feature was justified by the fact that the *C_v* were pursuing a "limited fund." This is a class action doctrine holding that where a non-debtor defendant has limited funds, an individual *C_i* should not be able to opt out and sue independently, because that would deplete the fund by imposing litigation costs on the defendant.²¹⁹

"Limited fund" certainly applies to *any* bankruptcy proceeding and portends a clash between bankruptcy and class-action law. In *Drexel*, the Second Circuit attempted, somewhat lamely, to deny the contradiction on incoherent grounds. Class actions are usually on the "first come, first served" basis. That is, when a class sues a defendant, the class strives to obtain a judicial lien on the defendant's assets and competes for those assets with other creditors of the defendant. Here, to the extent the class pursues *D Corp.* assets, the class shares pro rata with the other unsecured creditors of *D Corp.*, meaning that the class, fully paid as it was, obtained at least some of its compensation from non-debtor assets. The *Drexel* court remarked that "first come, first served" implies that "a mandatory class action will not be appropriate in most bankruptcy cases."²²⁰ This makes little sense, though admittedly class actions related to a bankruptcy have not reappeared in the Second Circuit.

But the *Drexel* court greatly confused matters by dragging bankruptcy doctrine into the matter. In addressing whether the injunction against suing the non-bankrupt defendants should have been stricken — that is, whether creditors should be able to "opt out" — the *Drexel* court said no, citing *Robins*, to which the *Drexel* court gave an expansive interpretation. Said the *Drexel* court, "[i]n bankruptcy cases, a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan."²²¹ At least in dictum, then, the Second Circuit supported a bankruptcy court's power to release third-party claims, though it should be remembered that *Robins* (and also *Drexel*) were eminent domain plans.

²¹⁹ See *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 829–33 (1999).

²²⁰ *In re Drexel Burnham Lambert Grp. Inc.*, 960 F.2d at 292.

²²¹ *Id.* at 293.

In her *Purdue* opinion, Judge McMahon did not conceal her impatience with *Drexel*. The *Drexel* court cited *Robins* broadly but “cited no section of the Bankruptcy Code that authorized this proposition” that releases can be approved if they are “important.”²²² She accused the Second Circuit of reasoning tautologically²²³ and referred to its analysis as “facile.”²²⁴ She saw *Drexel* as standing for the proposition that “the district court had discretion to approve non-debtor releases as part of [a] settlement of numerous securities fraud class actions in the context of a bankruptcy, simply and solely because funds were being funneled to the estate that would not otherwise be contributed.”²²⁵ Judge McMahon discounted *Drexel* as a binding authority for two reasons. First, the court did not ground the power to release in any Bankruptcy Code authority. Second, *Drexel* was decided before section 524(g) was enacted. *Drexel*’s:

[P]assing mention of a bankruptcy court’s power to enjoin a creditor from suing a non-debtor became far less persuasive after Congress (1) amended the Bankruptcy Code to authorize such injunctions, but only in asbestos cases; (2) expressed agnosticism about whether any such authority existed outside of its new legislation; and (3) indicated its intent to consider at some later time whether to extend this authority to industries that were “reportedly experimenting” with such injunctions — which it never has.²²⁶

We have argued, however, that Bankruptcy Code section 524(g) says nothing at all about theft plans,²²⁷ and so it is impossible to say that section 524(g) overrules *Drexel*.

Judge McMahon also implied that *Drexel* had been overruled by the Supreme Court in *Ortiz v. Fibreboard Corp.*,²²⁸ a nonbankruptcy class action involving asbestos claims. In *Ortiz*, asbestos torts threatened to sink *D Corp.* The major asset was liability insurance. The insurance companies offered to settle, but they required a mandatory non-opt-out class action with a channeling injunction barring further suit. Meanwhile, *D Corp.* was permitted to keep a modest amount of net worth. The lower courts permitted a mandatory settlement of all claims, but the Supreme Court reversed, mainly because *D Corp.* was not required to pay *all* its net worth into the settlement trust.

According to Judge McMahon, “the Supreme Court expressed grave doubt about whether the Rule 23(b)(1)(B) ‘limited fund class action’ device that was

²²² *In re Purdue Pharma, L.P.*, 635 B.R. 26, 97 (S.D.N.Y. 2021).

²²³ *See id.*

²²⁴ *See id.* at 98.

²²⁵ *See id.* at 97.

²²⁶ *See id.*

²²⁷ *See supra* text accompanying notes 78–79.

²²⁸ 527 U.S. 815 (1999).

employed in *Drexel* could ever be employed in the mass tort context like this one.”²²⁹ The point is confusing because neither *Drexel* nor *Ortiz* were really bankruptcy cases at all; they were class actions. Nor, to our eye, did the tortious nature of the claims in *Ortiz* make any difference to the Supreme Court. In any case, the *Metromedia* court thought *Drexel* was good law, and *Metromedia* was considerably after *Ortiz* was handed down. “It is, of course, for the Second Circuit to make that call — not a district court in the Second Circuit,” Judge McMahon conceded.²³⁰ Perhaps that call was made in *Metromedia*.

Judge McMahon further objected:

Moreover, the Supreme Court also said in *Ortiz* that a fund which is “limited” only because the contributing party keeps a large portion of its wealth (*a la* the Sacklers) is “irreconcilable with the justification of necessity in denying any opportunity for withdrawal of class members whose jury trial rights will be compromised, whose damages will be capped, and whose payments will be delayed.” The exact same thing could be said of the third parties whose claims are being extinguished as part of the Debtors’ Plan.²³¹

The analogy is not exactly apt. In *Ortiz*, the insurance companies paid the policy limit and *D Corp.* kept some net worth. In *Purdue*, the Sacklers kept some net worth and *D Corp.* retained nothing.

Be that as it may, Judge McMahon is ultimately correct that *Drexel* is not a relevant precedent. The case speaks about mandatory participation in a class action against various defendants, one of whom happened to be bankrupt; “[b]ut one thing is clear; *Drexel* sheds no light whatsoever on the issue of whether releases like the one at bar are authorized by the *Bankruptcy Code*. That statute was never mentioned.”²³² Her basic intuition that the *Bankruptcy Code* must authorize third-party releases is fundamentally sound, and to that question *Drexel* says nothing.

D. Summary

To sum up, Judge McMahon agreed with Judge Drain that the *Purdue plan* expropriated property rights of *C_v* to sue *AD* for the torts they affirmatively committed. Given that interpretation of the plan, the plan was not confirmable. In the main, Judge McMahon ruled that whatever is not expressly permitted is prohibited, and no provision permits third-party releases. But this throws all babies out with the bath water. Channeling injunctions become impossible on such

²²⁹ See *In re Purdue Pharma*, 635 B.R. at 97.

²³⁰ *Id.* at 98 n.63.

²³¹ *Id.* at 98 (quoting *Ortiz*, 527 U.S. at 860) (citation omitted).

²³² *Id.* at 99.

reasoning, but channeling injunctions are appropriate in cases which portend no theft of C_v rights.

Judge McMahon was less successful in arguing that the Bankruptcy Code affirmatively prohibits theft plans. She found three moments of prohibition: (1) a “knew-how-to” argument arising from section 524(g) pertaining to asbestos bankruptcies; (2) an inference from the fact that only *debtors* (not third parties) can get a discharge from bankruptcy; and (3) section 524(e) (discharge of a debtor “does not affect the liability of any other entity on . . . such debt”)²³³ prohibits third-party discharges.

None of these arguments are convincing. We have proposed that theft plans violate nonbankruptcy law, and that section 1129(a)(3) prohibits chapter 11 plans that violate nonbankruptcy law. On our analysis, theft plans are not confirmable, but eminent domain plans are consistent with the Bankruptcy Code as a whole.

V. JURISDICTION: A DISTRACTION

A distraction in the debate over third-party releases is the role of jurisdiction in considering whether a theft plan might be confirmed. Both Judges Drain and McMahon agreed there *was* jurisdiction. Their disagreement concerned whether the Bankruptcy Code authorizes third-party releases. Both judges were right to banish jurisdiction from the discussion. The only issue is whether the Bankruptcy Code permits the third-party release.²³⁴ If it does, then a release is a core action because plan confirmation is a core action,²³⁵ and either the bankruptcy court or the district court has jurisdiction to confirm it. But if the Bankruptcy Code *does not permit* third-party releases, then jurisdiction does not matter. A theft plan cannot be confirmed as a substantive matter, because it does not meet the criterion of Bankruptcy Code section 1129(a): “The plan complies with the applicable provisions of this title.”

According to section 1334 of the Judicial Code:

- (a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.
- (b) . . . [T]he district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.²³⁶

²³³ See *id.* at 107–08.

²³⁴ See *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) (“Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.”) (quoting *Variety Corp. v. Howe*, 516 U.S. 498, 519 (1996) (Thomas, J., dissenting)).

²³⁵ See 28 U.S.C. § 157(b)(L) (2018) (acknowledging core actions include confirmation of plans).

²³⁶ See *id.* § 1334(a)–(b).

There are four types of bankruptcy jurisdiction: (1) Exclusive jurisdiction over bankruptcy petitions; (2) non-exclusive jurisdiction “arising under;” (3) jurisdiction arising in; and (4) “related to” cases.²³⁷ If the Bankruptcy Code permits third-party releases, then (3) applies. The matter is “core.” If the Bankruptcy Code prohibits third-party releases, then jurisdiction is irrelevant. The plan cannot be confirmed.

For the record, Judge McMahon found that “related to” jurisdiction exists because:

[T]he Second Circuit defines that limit quite broadly. The standard is not that an action’s outcome will certainly have, or even that it is likely to have, an effect on the *res* of the estate, as is the case in some other Circuits. It is rather, whether it *might have any conceivable impact* on the estate.²³⁸

In particular, Judge McMahon cited the overlap between *C_I*’s claim against *AD* and *D Corp.*’s claim against *AD*. As previously emphasized, every dollar of claim *C_I* had against *AD* was a dollar in *D Corp.*’s claim against *AD*. These were overlapping claims, and therefore there was “related to” jurisdiction.²³⁹ In addition, *AD* had a contractual indemnity right, so that *AD*’s liability portended *D Corp.*’s liability for *AD*’s torts.²⁴⁰

The Third Circuit, in contrast, has held that plan confirmation is *always* a core action.²⁴¹ In *In re Millennium Lab Holdings II, LLC*,²⁴² a shareholder (*SH*) allegedly lied to *C_I* in order to induce a secured loan to *D Corp.* *D Corp.* fared badly and filed for chapter 11. A bankruptcy court confirmed a plan whereby *C_I* was to be paid in full. The plan barred *C_I* from suing *SH* for deceit and for RICO claims (treble damages). But where *C_I* was to be paid under the plan, *C_I*’s action against *SH* was meritless, as *C_I* was not damaged. *C_I* appealed, claiming it was unconstitutional for the bankruptcy court to confirm an eminent domain plan. According to *C_I*, confirmation of an eminent domain plan is not within the jurisdiction of the bankruptcy court and so was a nullity.

The Third Circuit disagreed. Confirmation was a core action and therefore within the jurisdiction of the bankruptcy court.²⁴³ Beyond that, the appeal was

²³⁷ Ralph Brubaker, *A “Summary” Statutory and Constitutional Theory of Bankruptcy Judges’ Core Jurisdiction After Stern v. Marshall*, 86 AM. BANKR. L.J. 121, 139–40 (2012) [hereinafter Brubaker, *Summary*].

²³⁸ *In re Purdue Pharma, L.P.*, 635 B.R. 26, 83 (S.D.N.Y. 2021) (emphasis in original) (citation omitted) (citing *SPV OSUS, Ltd. v. UBS AG*, 882 F.3d 333, 339–40 (2d Cir. 2018)).

²³⁹ *Id.* at 85.

²⁴⁰ *Id.* at 88.

²⁴¹ *Accord In re AOV Indus.*, 792 F.2d 1140, 1145 (D.C. Cir. 1986).

²⁴² 945 F.3d 126 (3d Cir. 2019), *cert. denied*, 140 S. Ct. 2805 (2020).

²⁴³ The jurisdiction question seems fallow to us. If a bankruptcy court cannot confirm a theft plan because this entails adjudicating (*i.e.*, releasing) a claim by *C_I* against *SH* based on state law, then the district court can issue the confirmation order, if it has a mind to condone theft. Nevertheless, the Third Circuit launched into a detailed examination of the inscrutable *Stern v. Marshall*, 564 U.S. 462 (2011). *Stern* supposedly

equitably moot because *SH* had already delivered the loot and it would be too tiresome to unwind affairs to do justice to *C_I*. The court did not quite get around to ruling that eminent domain plans are actually authorized by the Bankruptcy Code — only that if they are confirmed, equitable mootness precludes judicial review.²⁴⁴

C_I had claimed that the celebrated case of *Stern v. Marshall*²⁴⁵ prohibited the third-party releases. *Stern* involved a proof of claim by *AD* against *D* for defamation and *D*'s counterclaim against *AD* for intentional interference with a donative intent. The Supreme Court confirmed that “core proceedings include ‘counterclaims by the [bankruptcy] estate against persons filing claims against the estate.’”²⁴⁶ Although in the core, the counterclaim could not be tried by a bankruptcy court consistent with Article III of the Constitution. Article III guarantees *AD* a judge with a lifetime appointment.²⁴⁷ Bankruptcy judges don’t have lifetime appointments. They are Article I judges, appointed for a fourteen-year term.²⁴⁸

The *Stern* court admitted that adjudication of a “public right” could be allocated to an Article I judge. In the course of discussing what is or is not a public right, the court begged off on deciding whether “the restructuring of debtor-creditor relations is in fact a public right.”²⁴⁹ If it is, then bankruptcy courts can confirm eminent domain plans.²⁵⁰

stands for the notion that just because an adjudication is “core” doesn’t mean that an Article I judge can adjudicate it. But an Article I judge is not out of bounds if it resolves a matter than is integral to restructuring of debtor-creditor relations in a chapter 11 case. Since *SH*'s payoff was the *sine qua non* of the chapter 11 plan, a bankruptcy court could deprive *C_I* of its rights against *SH*. See *In re Millennium Lab Holdings II, LLC*, 945 F.3d at 134–38.

²⁴⁴ As Judge McMahon pointed out, *C_I* argued that the Third Circuit was opening the floodgates to theft and looting of third parties such as *C_I*. *In re Purdue Pharma*, 635 B.R. at 104. The court admitted this was a concern if a low bar was set for theft plans. Therefore, the court called for “exacting standards.” *Id.* at 139.

Although we are satisfied that both the Bankruptcy Court and District Court exercised appropriate — indeed, exemplary — caution and diligence in this instance, nothing in our opinion should be construed as reducing a court’s obligation to approach the inclusion of nonconsensual third-party releases or injunctions in a plan of reorganization with the utmost care and to thoroughly explain the justification for any such conclusion.

In re Millennium Lab Holdings II, LLC, 945 F.3d at 139. Yet the bankruptcy and district courts in *Millennium* never said anything more than that *SH* would not make the payoff unless it received the release.

²⁴⁵ 564 U.S. at 462.

²⁴⁶ *Id.* at 475.

²⁴⁷ See *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 35 (2014) (“*Stern* made clear that some claims labeled by Congress as ‘core’ may not be adjudicated by a bankruptcy court in the manner designated by [28 U.S.C.] § 157(b).”).

²⁴⁸ 28 U.S.C. § 152(a)(1) (2018).

²⁴⁹ *Stern*, 564 U.S. at 492 n.7.

²⁵⁰ The *Stern* court had a tough time, to say the least, in distinguishing *Katchen v. Landy*, 382 U.S. 323 (1966). For an analysis of the difficulties, see Brubaker, *Summary*, *supra* note 237, at 162–64. In *Katchen*, the Supreme Court ruled that a non-Article III judge could adjudicate a voidable preference counterclaim against *AD* where *AD* had filed a proof of claim in the bankruptcy. *AD*'s claim against *D* was allowable only if *AD* had not received a voidable preference. But in *Stern*, *AD*'s defamation claim was fully allowable, though it was subject to a setoff. Therefore, *AD* had a right to an Article III judge. The *Stern* court said, “the question is whether the [intentional interference] action at issue stems from the bankruptcy itself or would

Reading *Stern*, the Third Circuit in *Millennium* drew the following lessons:

First, bankruptcy courts may violate Article III even while acting within their statutory authority in “core” matters. . . . Second, a bankruptcy court is within constitutional bounds when it resolves a matter that is integral to the restructuring of the debtor-creditor relationship. . . . The third take-away from *Stern* is that, when determining whether a bankruptcy court has acted within its constitutional authority, courts should generally focus not on the category of the “core” proceeding but rather on the content of the proceeding.²⁵¹

The *Millennium* court concluded that an Article I court could take action with regard to “a matter integral to the restructuring of the debtor-creditor relationship.” And in determining whether that is the case, we can consider the content of the “core proceeding” at issue.²⁵² Thus, a bankruptcy court could confirm a plan because barring *C_I*’s RICO claim against *AD* “was resolving a matter integral to the restructuring of the debtor-creditor relationship.”²⁵³ The bankruptcy court had found the release provisions to be critical to success of the plan.

Oddly, if *C_I* had persuaded the *Millennium* court that, under *Stern*, a bankruptcy court could *not* confirm a plan extinguishing the RICO claim, then the district court could surely confirm it. This just recharacterizes the bankruptcy court’s confirmation order into a recommendation to the district court that the plan be confirmed.²⁵⁴ In any case, in the Third Circuit, the bankruptcy court can confirm plans generally. Ordinarily, *C_I* could appeal the confirmation order on statutory grounds, but the appeal had become equitably moot and so an appeal on the merits was not possible. Confirmation of the eminent domain plan survived, thanks to equitable mootness.

necessarily be resolved in the claims allowance process.” *Stern*, 564 U.S. at 499.

The *Stern* court also acknowledged the rightness of *Langenkamp v. Culp*, 498 U.S. 42 (1990). There, the issue was whether *AD*, who had filed against *D Corp.*, was entitled to a jury trial on *T*’s counterclaim for voidable preference. The Supreme Court had recently ruled that, where *AD* had *not* filed a proof of claim in the bankruptcy, *AD* was entitled to a jury. *Granfinanciera v. Nordberg*, 492 U.S. 33 (1989). But in *Langenkamp*, *AD* was *not* entitled to a jury because the counterclaim becomes part of the claims-allowance process which is triable only in equity. In other words, the creditor’s claim and the ensuing preference action by the trustee become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court’s equity judgment. *Langenkamp*, 498 U.S. at 44. For the view that *Granfinanciera* was based on bad historical analysis, see David Gray Carlson, *Fraudulent Transfers and Juries: Was Granfinanciera Rightly Decided?*, 95 AM. BANKR. L.J. 209 (2021); John C. McCoid, II, *Right to Jury Trial in Bankruptcy: Granfinanciera, S.A. v. Nordberg*, 65 AM. BANKR. L.J. 15 (1991).

²⁵¹ *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 135–36 (3d Cir. 2019).

²⁵² *Id.* at 137.

²⁵³ *Id.*

²⁵⁴ See *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25, 34 (2014); see also *In re Purdue Pharma, L.P.*, 635 B.R. 26, 37, 79 (S.D.N.Y. 2021).

In contrast, Judge McMahon in *Purdue* was of the opinion that, if confirmation extinguished a *Stern* claim, confirmation was beyond the power of an Article I judge. Nevertheless, an Article III judge could confirm, as a matter of jurisdiction.²⁵⁵

Judge Drain did not have the power to enter an order finally approving [the non-consensual releases]. To the extent of his approval of the Section 10.7 Shareholder Releases, his opinion should have been tendered as proposed findings of fact and conclusions of law, both of which this court could review *de novo*. If approved by this Court, those releases would of course be incorporated into the plan.²⁵⁶

But Judge McMahon declined to confirm the plan because theft plans are not authorized by the Bankruptcy Code. Jurisdiction, it seems, had fallen out of the equation.

Judge McMahon implied that confirming plan is not a core action, even though section 157(b)(L) of the Judiciary Act says so directly.²⁵⁷ Her idea seemed to be that confirmation of the plan (minus section 10.7 of the *Purdue plan*) is core, but

²⁵⁵ See *In re Purdue Pharma*, 635 B.R. at 80. Judge McMahon disagreed with *Millennium* that *Stern* authorized plan confirmation when third-party claims were extinguished, but in so opining she erred (slightly):

In *Stern*, the Supreme Court held that bankruptcy courts have the power to enter a final judgment only in proceedings that “stem[] from the bankruptcy itself or would necessarily be resolved in the claims allowance process.” It did not say that a bankruptcy court could finally dispose of non-core proceedings as long as they were “integral to the restructuring of the debtor-creditor relationship.” The counterclaim in the lawsuit between debtor Marshall and her stepson-creditor was integral to the restructuring of their debtor-creditor relationship, but it was not a core proceeding, so the bankruptcy court could not finally adjudicate it. The correct constitutional question, and the question on which the Bankruptcy Court should have focused in this case, is whether the third-party claims released and enjoined by the Bankruptcy Court either stem from the bankruptcy interest and would necessarily be resolved in the claims allowance process—not whether the release and injunction are “integral to the restructuring of the debtor-creditor relationship.”

Id. at 81 (citation omitted). This errs in that *Stern* does indeed affirm that jurisdiction over the counterclaim was core. The Third Circuit was out on a limb, however, as to whether *Stern* does not apply to plan confirmation.

²⁵⁶ *Id.* at 82 (citation omitted). On the implications following the proposition that bankruptcy court cannot confirm eminent domain plans, see Eamonn O’Hagan, *On a “Related” Point: Rethinking Whether Bankruptcy Courts Can “Order” the Involuntary Release of Non-Debtor, Third-Party Claims*, 23 AM. BANKR. INST. L. REV. 531, 534 (2015).

²⁵⁷ See *Stern v. Marshall*, 564 U.S. 462, 477 (2011) (“Pierce argues that we should treat core matters that arise neither under Title 11 nor in a Title 11 case as proceedings ‘related to’ a Title 11 case. We think that is a contradiction in terms. It does not make sense to describe a ‘core’ bankruptcy proceeding as merely related to’ the bankruptcy case; oxymoron is not a typical feature of congressional drafting.”) (citations omitted); see also *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1984) (“[T]he restructuring of debtor-creditor relations . . . is at the core of the federal bankruptcy power . . .”).

confirming the nonconsensual release falls under “related to” jurisdiction. In this Judge McMahon either misunderstood *Stern* to say that *Stern* claims can never be core, or she has bought into an idea floated by Professor Brubaker, implacable opponent of constitutionality of third-party releases. According to Professor Brubaker, the “jurisdictional” unit is not the plan, which is core and could be confirmed by a district court.²⁵⁸ Rather, the jurisdiction unit is *C_I* v. *AD*. This must rise and fall under “related to” jurisdiction.²⁵⁹ But this displacement from core to penumbra still doesn’t change the fact that, under *Stern*, a district court could confirm the plan.

In truth, all this jurisdictional talk is unnecessary. *Some* court has jurisdiction to confirm plans — either the bankruptcy court or perhaps the district court. The issue is whether the plan is confirmable under the Bankruptcy Code. If so, the matter is core and the bankruptcy courts have jurisdiction.

Millennium overrules the Third Circuit’s earlier opinion in *In re Combustion Engineering, Inc.*,²⁶⁰ where *D Corp.* and sibling subsidiaries (*E* and *F Corp.*) sold products containing asbestos. *D Corp.* arranged for *E* and *F Corp.* to pay money into a trust fund.²⁶¹ In exchange for their contributions, the plan provided for a permanent injunction barring suits against *E Corp.* and *F Corp.* The *C_V* with claims against *D Corp.* and also with claims against *E Corp.* and *F Corp.* were limited to a distribution from this trust. They were permanently forbidden to bring actions against *E Corp.* or *F Corp.* The purpose of this arrangement was to render *E Corp.* and *F Corp.* free of tort debt, so that the holding company owning all three subsidiaries could sell shares in *E Corp.* and *F Corp.* for cash to some buyer. The plan was based on expropriating the right of *C_V* to bring tort action against *E Corp.* or *F Corp.* But the plan also promised payment in full, after a fashion, to the *C_V* whose rights against *E Corp.* and *F Corp.* were expropriated. The *E-F* contribution was actually *not* enough to pay the *C_V* in full, but the *C_V* voting for the plan were sufficiently large in number that the holdouts could recover 100% from the trust. Thus, consenting *C_V* were not paid in full but dissenters could recover 100%.

The Third Circuit in *Combustion Engineering* ruled that the bankruptcy court had no jurisdiction to approve such plans, because confirmation of such a plan does

²⁵⁸ See Ralph Brubaker, *A Case Study in Federal Bankruptcy Jurisdiction: Core Jurisdiction (or Not) to Approve Non-Debtor “Releases” and Permanent Injunctions in Chapter 11*, 38 No. 2 BANKR. L. LETTER, at 1 (Feb. 2018) (*Millennium* “misperceive[s] the applicable jurisdictional unit at issue when a judge is asked to approve a non-debtor ‘release.’ The relevant litigation unit, for purpose of jurisdictional analysis, is *not* the plan confirmation ‘proceeding.’ The jurisdictional unit over which the judge must exercise jurisdiction in order to approve a non-debtor ‘release’ is each individual jurisdictional ‘claim’ of a creditor against a non-debtor that is sought to be extinguished via nonconsensual ‘release’ thereof.”) (emphasis in original).

²⁵⁹ Professor Brubaker draws this jurisdictional atomism from *In re Combustion Engineering, Inc.*, 391 F.3d 190, 224–25 (3d Cir. 2004), a case that *Millennium* overrules, as we shall soon discuss. See *infra* text accompanying notes 253–54.

²⁶⁰ 391 F.3d 190 (3d Cir. 2004).

²⁶¹ The money paid represented insurance coverage *E Corp.* and *F Corp.* shared with *D Corp.* See *id.* at 210. It could be observed that *D Corp.* could simply *take* the entire policy; *E Corp.* and *F Corp.* could not prevent this. See *Quigley Co. v. L. Offs. of Peter G. Angelos (In re Quigley Co.)*, 676 F.3d 45 (2d Cir. 2011), *cert. denied sub nom. Pfizer, Inc. v. L. Offs. of Peter G. Angelos*, 570 U.S. 917 (2013).

not “relate to” a bankruptcy proceeding — a proposition that defeats itself upon the stating of it. Third Circuit reasoning depended on a syllogism: (1) Third-party releases in chapter 11 plans are adjudications between *C_I* and *AD*. (2) Third-party adjudications must be “related to” the bankruptcy. Therefore, (3) a plan can be confirmed only if the third-party release is “related to” the bankruptcy.

In *Combustion*, the plan released claims against *E* and *F Corp.* when there was no indemnity right for *E* and *F Corp.* against its bankrupt sibling *D Corp.* In the Third Circuit, *Pacor, Inc. v. Higgins*²⁶² stood for the proposition that a suit by *C_v* against *X* was not “related to” simply because *X* could turn around and make a claim against *D Corp.* for indemnity, because *C_v v. X* served only to identify which between *C_v* or *X* would make an unsecured claim against *D Corp.* The release in *Combustion* was therefore doubly unrelated to the bankruptcy, there was no indemnity right and, even so, indemnity rights do not justify “related to” jurisdiction. The Third Circuit rejected the idea that *C_v v. E & F Corp.* was “related to” because *E & F Corp.* had agreed to the pay into trust, and this was necessary for the plan to be confirmed. “If that were true, a debtor could create subject matter jurisdiction over any non-debtor third-party by structuring a plan in such a way that it depended upon third-party contributions.”²⁶³ But if indeed the Bankruptcy Code authorizes third-party releases, jurisdiction was better than “related to.” It was in the core.

Jurisdiction is a bootless concept and we should not talk about it. Plan confirmation is in the core, and the only issue is whether the Bankruptcy Code authorizes plan confirmation or not.²⁶⁴ This proposition is proven by the Supreme Court’s opinion in *Stoll v. Gottlieb*,²⁶⁵ which involved a reorganization plan that released *C_I*’s suretyship right against *AD*. The bankruptcy referee confirmed the plan and *C_I* did not appeal, confident that the referee had no jurisdiction to do what he did. After confirmation, *C_I* sued *AD* on the discharged guaranty and was booted from court on *res judicata* grounds. The Supreme Court reasoned that lack of jurisdiction had to be raised on appeal from the referee’s confirmation order. The referee had jurisdiction to decide its own jurisdiction. Having decided for jurisdiction, this became binding on *C_I*.²⁶⁶ The holding proves that jurisdiction *vel non* is just another way of inquiring into whether the Bankruptcy Code authorizes confirmation. If so, the court has jurisdiction. If not, the plan cannot be confirmed, and jurisdiction falls out of the equation. Either way, *C_I* must get relief from appealing the confirmation order. Collateral attacks are on the plan out!²⁶⁷

²⁶² 743 F.2d 984 (3d Cir. 1984).

²⁶³ *Combustion*, 391 F.3d at 228. It should be noted that, in *Combustion*, *D* and *F Corp.* were to pay sums to a pre-petition trust beyond the bounds of the bankruptcy estate. Therefore, *C_v v. D* and *F Corp.* could not have any effect on the estate being administered in bankruptcy. *Id.* at 230.

²⁶⁴ See generally David Gray Carlson, *The Federal Rules of Bankruptcy Procedure in Reorganization Cases: Do They Have a Constitutional Dimension?*, 84 AM. BANKR. L. REV. 251 (2010); David Gray Carlson, *The Res Judicata Worth of Illegal Bankruptcy Plans*, 82 TEMP. L. REV. 351 (2009).

²⁶⁵ 305 U.S. 165 (1938).

²⁶⁶ *Accord* Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1052 (5th Cir. 1987).

²⁶⁷ *Accord* Celotex Corp. v. Edwards, 514 U.S. 300, 315 (1995) (Stevens, J., dissenting).

*Monarch Life Insurance Co. v. Ropes & Gray*²⁶⁸ shows that jurisdiction talk is simply unnecessary. *D Corp.* owned a subsidiary *S Corp.* *S Corp.* lent funds to *D Corp.* on advice of its attorney, *A*. *D Corp.* was petitioned into bankruptcy, and a plan was confirmed, which included an injunction against “commencement . . . of any action . . . related to a claim against the Debtor . . . and their respective . . . attorneys”²⁶⁹ *S Corp.* filed a claim in the *D Corp.* bankruptcy. It did not appeal from the confirmation order. Later, *S Corp.* commenced a malpractice action against *A* in state court. *A* scurried to the bankruptcy court and filed a motion for civil contempt against *S Corp.* The First Circuit treated the question as whether the Bankruptcy Code authorized third-party releases; whether it did or not was irrelevant because *S Corp.* was bound by *res judicata*. Jurisdiction simply did not matter.

That jurisdiction is a bootless concept is proven in a negative way by *Johns-Manville Corp. v. Chubb Indemnity Insurance Co. (In re Johns-Manville Corp.)*,²⁷⁰ where *C_I* sued the insurer in spite of the channeling injunction.²⁷¹ *C_I* alleged that the insurer breached a duty to *C_I* by failing to disclose health information.²⁷²

Upon being sued, the insurer scampered back to the bankruptcy court to enjoin *C_I* from suing. The bankruptcy court ruled that the insurer was being charged with “acts or omissions by [the insurer] arising from or relating to . . . insurance relationships with [*D Corp.*].”²⁷³ The alleged acts arose out of and were “related to” the IP.²⁷⁴

The court of appeals reversed. It saw the issue as “primarily a question of jurisdiction.”²⁷⁵ It ruled that where *C_I*’s claim was “non-derivative,” *i.e.*, particularized, a bankruptcy court did not even have jurisdiction to enjoin *C_I* from suing the insurer. *C_I*’s action was not derivative of its claim against *D Corp.* It was based on the acts of the insurer and did not impact upon the limit of the insurance policy.²⁷⁶ In this case, “non-derivative” meant no impact on the insurance receivable.²⁷⁷ Taken on this ground, the case violates the *Stoll* principle. The

²⁶⁸ 65 F.3d 973 (1st Cir. 1995).

²⁶⁹ *Id.* at 976. *A* contributed nothing to the bankruptcy estate in exchange for this release. *Id.* at 980.

²⁷⁰ 517 F.3d 52 (2d Cir. 2008), *rev’d sub nom.* Travelers Indem. Co. v. Bailey, 557 U.S. 137 (2009).

²⁷¹ “The Confirmation Order simultaneously enjoins ‘all persons’ from commencing any action against any of the Settling Insurance Companies ‘for the purpose of, directly or indirectly, collecting, recovering or receiving payment of, on or with respect to any Claim . . . or Other Asbestos Obligation.’” *Id.* at 57 (internal citation omitted).

²⁷² “Many of these theories of liability have not been accepted by any court.” *Id.* at 58.

²⁷³ *Id.* at 59.

²⁷⁴ *Id.*

²⁷⁵ *Id.* at 60.

²⁷⁶ *Id.* at 65 (“Here . . . [the *C_I*] seek[s] to recover directly from a debtor’s insurer for the insurer’s own independent wrongdoing. . . . They raise no claim against [*D Corp.*]’s insurance coverage.”); *see also In re Johns-Manville Corp.*, 600 F.3d 135, 145–46 (2d Cir. 2010) (per curiam).

²⁷⁷ The Supreme Court reversed, basically, on other grounds. Travelers Indem. Co. v. Bailey, 557 U.S. 137, 147 (2009). It ruled that *C_I* was clearly covered by the channeling injunction and that, right or wrong, *res judicata* prevented revisiting whether a channeling injunction can constitutionally bar suits against insurers for insurer wrongdoing. *Id.* at 152; *see also id.* at 155 (“Our holding is narrow. We do not resolve whether a bankruptcy court, in 1986 or today, could properly enjoin claims against nondebtor insurers that

bankruptcy court issued the channeling injunction and, if it was overbroad, it became binding because the bankruptcy court had the power to decide its own jurisdiction. What the Second Circuit was really saying was that the channeling injunction did not mean to bar particularized creditor rights. It meant only to bar assaults on the policy amount, and since *C_I* was asserting a particularized creditor right, the channeling injunction simply did not apply. Jurisdiction should never have been mentioned.

An early and classic study of third-party releases was published twenty-five years ago by Professor Ralph Brubaker,²⁷⁸ who makes potent arguments against theft plans and also eminent domain plans on policy and statutory grounds. Over half of this lengthy study makes jurisdiction front and center. In this part of the article Professor Brubaker makes ponderous distinctions between temporary stays (always in the core)²⁷⁹ and permanent stays (which are adjudications).²⁸⁰ In the end, his jurisdictional objection falls apart. “Related to” jurisdiction, he admits, is easy to find. One need find *some* conceivable connection between the third-party release and the administration of the bankruptcy proceeding. He makes the good point that, under *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*,²⁸¹ *C_I* is entitled to adjudication before an Article III judge; therefore district courts, but not bankruptcy courts, can confirm theft plans²⁸² (a point on which Judge McMahon agreed). But in the end he is reduced to complaining that “related to” jurisdiction is simply too expansive to lend his policy argument much weight.²⁸³

A different sort of claim is made by Professor Thomas E. Plank,²⁸⁴ who argues that, *even if* the Bankruptcy Code authorizes eminent domain plans (not to mention

are not derivative of the debtor’s wrongdoing.”). The Second Circuit opinion therefore has validity as a comment on what a channeling injunction is capable of doing. In fact, a *C_I* was held to be outside the channeling injunction because its claim against the insurer was nonderivative. *In re Johns-Manville Corp.*, 600 F.3d at 157–58. See Brubaker, *Clarified*, *supra* note 155, at 5.

In *Continental Casualty Co. v. Carr (In re W.R. Grace & Co.)*, 900 F.3d 126 (3d Cir. 2018), the court, in a case with facts identical to *Chubb*, ruled that the channeling injunction potentially protected *IC* because *IC* would not have undertaken to publicize health information if *D Corp.* had not hired *IC* to do so. Therefore, *IC* could hide behind the channeling injunction even though its liability for breach of this duty was its own and would not reduce *D Corp.*’s insurance receivable. For *C_I* to prevail, *C_I* had to show that *IC*’s misconduct was “wholly independent” of *D Corp.*’s defective product. The court, however, stopped short of ruling that the channeling injunction protected *IC*. This would depend on whether Montana law viewed the health disclosures as part and parcel of the service of insuring *D Corp.* from product liability. The case was remanded for the bankruptcy court to determine what “providing insurance” means in Montanese. *In re W.R. Grace & Co.*, 900 F.3d at 137.

²⁷⁸ See Brubaker, *Complex Litigation*, *supra* note 206.

²⁷⁹ *Id.* at 1062–67.

²⁸⁰ *Id.* at 1070 (“The release operates as an adjudication on the merits, fully binding for res judicata/preclusion purposes.”).

²⁸¹ 458 U.S. 50 (1982).

²⁸² See Brubaker, *Complex Litigation*, *supra* note 206, at 1070; see also Brubaker, *Summary*, *supra* note 237, at 172.

²⁸³ See Brubaker, *Complex Litigation*, *supra* note 206, at 1069. See Cal. Div. of Lab. Standards Enf’t v. Dillingham Constr. N.A., Inc., 519 U.S. 316, 335 (1997) (“[A]s many a curbstone philosopher has observed, everything is related to everything else.”) (Scalia J., concurring).

²⁸⁴ See *infra* note 285, at 636–39.

theft plans), such an authorization exceeds the power of Congress to make uniform bankruptcy laws. Professor Plank finds a “non-expropriation principle” that limits congressional power to pass bankruptcy laws. “For example, Congress may not . . . appropriate property interests of third parties for distribution to creditors.”²⁸⁵ He asserts that a third-party release in a joint-and-several-liability case is unconstitutional as a legislative matter, even where C_I is compensated in full for the appropriation of her right against AD . But this overlooks the fact that AD breaches a duty to $C Corp.$ when AD causes $D Corp.$ to harm C_I , at least where AD is an officer of $D Corp.$ When C_I bolts from the bankruptcy to sue AD directly, AD is expropriating T 's property (while simultaneously exercising C_I 's personal right against AD). This fact triggers the marshaling-assets doctrine on display in the *Robins* case, where C_I is paid in full by AD 's contribution to the plan. And this fits within a legitimate congressional power that Professor Plank induces a non-interference principle: “The Non-Interference Principle provides an important but limited constraint on the Non-Expropriation Principle. Under this principle, Congress may prevent a third party from using its nonbankruptcy entitlements to impede the bankruptcy process.”²⁸⁶ Since C_I 's action against AD reduces T 's fiduciary receivable against D , the third-party release falls under the non-interference principle, which trumps (in a limited way) the non-expropriation principle.

CONCLUSION

Purdue Pharma is a bankruptcy case for the ages, placing front and center the ability of a chapter 11 plan to effectuate third-party releases. In this article, we have argued that a great many so-called releases are nothing but the doctrine of *res judicata*, backed up with a channeling injunction reserving for the bankruptcy court the right to determine which suit against a settling third party is or is not barred by *res judicata*. Other releases express the idea of qualified immunity of players with a chapter 11 proceeding.

But some releases expropriate the rights of creditors to bring tort actions against third parties. Even here, where the creditors are fully compensated for their loss of rights, the release is a species of eminent domain, arguably part of the equitable doctrine of marshaling assets.

The one plan that is out of bounds is the plan that releases third parties from tort liability, where the tort victims are *not* compensated in full. We have styled such plans as theft plans.

Was *Purdue Pharma* a theft plan? We say no. The literal language of the plan as written just expresses the concept of *res judicata*. It does not release third parties from tortious behavior they themselves committed in their personal capacities. It gave precious little or no protection to the Sackler family, to the extent the Sacklers

²⁸⁵ Thomas E. Plank, *The Erie Doctrine and Bankruptcy*, 79 NOTRE DAME L. REV. 633, 647 (2004).

²⁸⁶ *Id.*

were tortfeasors.

But Judge Drain introduced a very expansive concept of derivative claims. His idea was that the tort liability of the Sackler family to third parties was also liability to Purdue Pharma. The debtor-in-possession could therefore serve as representative for the individual creditors against the Sackler family. As representative, the debtor-in-possession could bind the injured tort victims to a mandatory settlement, even though the settlement did not come close to paying the tort victims in full. No doubt the Sacklers thought — or hoped — that this is what the plan said. So interpreted the plan was a theft plan, which could not be confirmed.

In short, the plan as written could be confirmed. The plan as interpreted by Judges Drain and McMahon could not be confirmed.