AMERICAN BANKRUPTCY INSTITUTE

New York City Bankruptcy Conference

Recent Confirmation Issues

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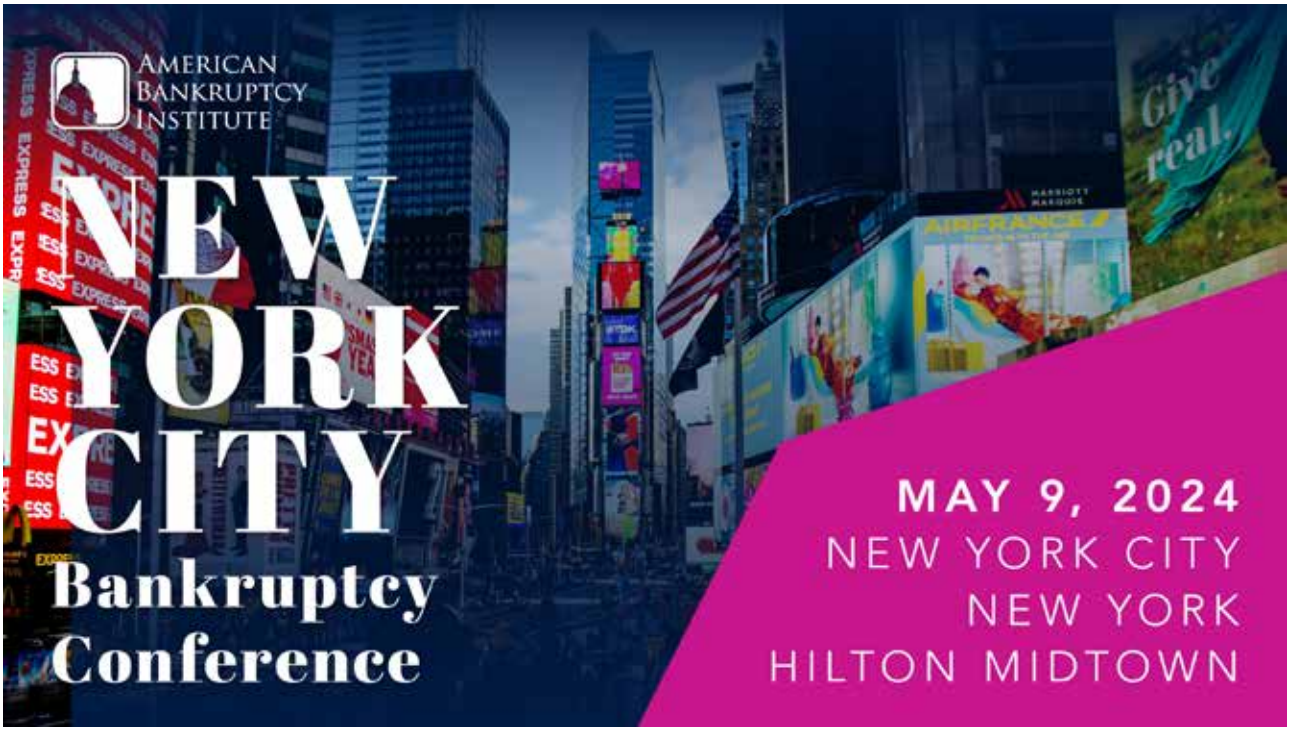
CONCURRENT SESSION

2024



Current Confirmation Issues

ABI New York Bankruptcy Conference

May 9, 2024

New York, NY

Panelists: 10:15 a.m. session

- Hon. Brendan Linehan Shannon, U.S. Bankruptcy Court (D. Del.)
- Lisa M. Schweitzer, *Partner*, Cleary Gottlieb Stein & Hamilton LLP
- Erica S. Weisgerber, *Partner*, Debevoise & Plimpton LLP
- Paul H. Zumbro, *Partner*, Cravath, Swaine & Moore LLP
- Rachel Jaffe Mauceri, *Partner*, Robinson & Cole LLP (moderator)

Panelists: 11:45 a.m. session

- Hon. Brendan Linehan Shannon, U.S. Bankruptcy Court (D. Del.)
- Evan C. Hollander, *Partner*, Orrick, Herrington & Sutcliffe LLP
- Rachael L. Ringer, *Partner*, Kramer Levin Naftalis & Frankel LLP
- Cullen Drescher Speckhart, *Partner*, Cooley LLP
- Rachel Jaffe Mauceri, *Partner*, Robinson & Cole LLP

Today's Discussion

- Plan Process-Related Topics
  - The increasing use of conditional disclosure statements
  - Toggle plans
  - Lock-Ups and Restructuring Support Agreements
- What's Happening With Equitable Mootness
- The Current Landscape of Releases and Exculpation

Conditional Disclosure Statements

- Bankruptcy Code § 1125 requires that a disclosure statement include "adequate information" that would enable a hypothetical investor "to make an informed judgment about the plan"
- Subject to exceptions for Subchapter V and small business cases, Fed. R. Bankr. P. 3017 contains a minimum 28-day notice period for a hearing on the adequacy of the disclosure statement
  - Delaware (Del. L. Bankr. R. 3017-2) requires a 28-day objection period and 35 days notice
- Section 105(d) authorizes courts to issue orders "to ensure that the case is handed expeditiously and economically" and subsection (vi) specifically contemplates the combining of disclosure statement and confirmation hearings

Conditional Disclosure Statements

- Potential benefits include efficiency and savings
- Not without risks
  - Plans may be patently unconfirmable, and thus rejected at the disclosure phase
  - Combined hearing may elicit objections related to adequacy of the disclosure statements and other points
  - Plan proponents could find themselves back at square one
- Recent cases allowing conditional disclosure statements
  - BlockFi – conditional approval granted August 2023; ultimately approved/plan confirmed Sept. 2023
  - GenesisCare – conditional approval granted October 2023; ultimately approved/plan confirmed Nov. 2023
  - Rite Aid – conditional approval granted March 2024; confirmation hearing pending
  - Bird Global – conditional approval granted April 29, 2024; solicitation underway

Toggle Plans

- Toggle plans allow a debtor flexibility to pursue multiple avenues of reorganization, typically a sale process vs. standalone recapitalization/debt-to-equity swap
- Benefits include a maximization of assets and, potentially, enhanced creditor recoveries
- Risks
  - Risks to estate includes increased costs followed by the inability to find committed bidders, particularly following an unsuccessful pre-petition attempt to market the company
  - Risks to creditors (and confirmation risk): not knowing exactly what they are voting for; a plan that can change materially even after the voting deadline
  - Requests for vote changes/resolicitation

Toggle Plans

- *Celsius Network LLC*
  - Celsius filed in July 2022 amid a series of crypto filings during the pandemic
  - Celsius's plan contemplated a restructuring through *either* a NewCo (managed by Fahrenheit, the prevailing bidder), or a wind-down including a mining-only public company (managed by back-up bidder Blockchain Recovery Investment Consortium, or BRIC)
  - A vote in favor was a vote for either transaction
  - Following confirmation, the SEC declined to approve the NewCo transaction, but said it would not require preclearance for the mining only company
  - Thereafter, Celsius sought approval to implement the winddown, with US Bitcoin as sponsor
    - The Debtors separately settled with BRIC

Toggle Plans

- *Celsius Network LLC*
  - The UST and a borrower group objected, arguing among other things that the new transaction was a material modification requiring additional disclosure and resolicitation under Bankruptcy Code section 1127 and that it altered the substantive rights of creditors, whose recoveries would change
  - The Debtors argued that the transaction was not a modification at all, but even if it were, resolicitation was only required if the modification was material and adverse, which it was not, as recoveries were increased by approximately $294 million over the original wind-down proposal
  - The Bankruptcy Court permitted the alternative transaction, and issued an opinion in late December 2023
    - The DS and Plan expressly contemplated the alternative transaction and was not a modification
    - In any event, the change did not run afoul of Bankruptcy Code 1127 as it did not "materially and adversely" harm creditors

Lock-Up Agreements and Restructuring Support Agreements

- Bankruptcy Code § 1126(e) requires the designation of any vote by an entity whose acceptance or rejection od the plan was not in faith, or which was not solicited or procured in good faith or in accordance with the Code
- That does not mean that all negotiated, arms'-length voting agreements are made per se in bad faith or in violation of the Code
  - See, *e.g., In re Indianapolis Downs, LLC* , 486 B.R. 286, 297 (Bankr. D. Del. 2013) Where post-petition lockup agreements are negotiated in good faith between a "debtor and sophisticated parties," and are thereafter promptly disclosed, Section 1126 does not "automatically require" the designation of votes by parties to a post-petition RSA
- Still, voting agreements must contain sufficient information about the plan, and about the circumstances under which creditors must vote in favor

Lock-Up Agreements and Restructuring Support Agreements

- In *In re GOL Linhas Aéreas Inteligentes S.A.* (Case No 24-10118 Bankr. S.D.N.Y.), J. Glenn, just a few weeks ago, declined to approve what he found to be an impermissible lock-up
- In *GOL*, the Debtors filed several motions seeking approval to enter into certain agreements and stipulations with various aircraft lessor counterparties
- Each included a provision requiring the counterparty to support any plan proposed by the Debtors, a long as it included the term of the applicable stip
- No separate restructuring support agreement was negotiated and executed

Lock-Up Agreements and Restructuring Support Agreements

- Both the UST and the Committee objected to the lockup provisions, citing among other provisions Section 1125(b)
  - UST noted that the lock-up provision did not contain meaningful "outs"
  - Objections cited concerns raised *sua sponte* by Judge Wiles in *SAS*, where he rejected a similar arrangement, and by Judge Garrity in *LATAM*, where the provision was struck before a ruling
- The Debtors defended the lockup provisions in their reply brief, but agreed with the counterparties that the court could, in alterative, simply strike the lock-up provision and grant the remaining relief

Lock-Up Agreements and Restructuring Support Agreements

- The Bankruptcy Court did so from the bench and subsequently issued an opinion, noting that properly negotiated RSAs are common and generally approved, and that even plan support provisions/lockups are not per se improper, if
  - There is sufficient information about the plan itself that creditors were committing to vote for; and
  - If creditors had meaningful choice – i.e., the ability to willingly agree or later rescind based on the information later available
- In *GOL*, the Debtors were months from filing a disclosure statement and plan, and the court found that the counterparties' conditions to exit were not meaningful
- The court also found that the lock-up, which could have created enough votes for a cramdown, could disenfranchise smaller creditors
- Judge Glenn approved the stipulations without the cramdown

Equitable Mootness

- Court created doctrine that examines whether principles of equity moot the propriety of a confirmation appeal where a plan has been substantially consummated
  - Promotes finality and protect parties that have relied on the bankruptcy court's confirmation order and transactions effectuated as part of that order
- Courts have not adopted a uniform test and the test varies by circuit, with some overlap
- Supreme Court has, to date, declined to address the doctrine, although in dicta *MOAC Mall Holdings LLC v. Transform Holdco LLC*, a case addressing mootness in the context of a sale

Equitable Mootness

- The Supreme Court was most recently asked to consider the split in the confirmation context in a petition arising out of the *Windstream* bankruptcy
- Windstream's plan was confirmed in June 2020
- U.S. Bank was indenture trustee to over $1 billion in unsecured notes that received no distribution, and appealed confirmation and sought a stay pending appeal
- Both the stay and an expedited appeal were denied and the plan went effective while the appeals were pending
- The District Court dismissed the appeal on equitable mootness grounds and the Second Circuit agreed
- Second Circuit affirmed the District Court in October 2022, following Second Circuit precedent (plan was substantially consummated and presumed moot), and denied rehearing in December 2022

Equitable Mootness

- U.S. Bank sought certiorari, asking two questions:
  - whether the lack of statutory and constitutional basis for the equitable mootness doctrine, combined with its demonstrated potential for abuse, requires it to be abolished; and
  - whether the Second Circuit's rule that an appeal from a substantially consummated bankruptcy plan is automatically equitably moot if the appellant did not pursue a stay, regardless of a stay's availability or any other equitable factors, undermines any prudential purpose for the doctrine
- Supreme Court denied cert. in October 2023
- Worth noting that the Second Circuit's order was summary and nonprecedential

Equitable Mootness

- Second Circuit's presumptive test is not followed in a number
- In the recent *Highland* decision, the Fifth Circuit was asked to dismiss the appeal on equitable mootness grounds for fear that unwinding the implemented Plan of "generat[ing] untold chaos."
- The court declined, and looked rather at the specific relief in question:
  - Releases: the legality of a non-consensual, non-debtor release is "consequential" to the Chapter 11 process and "should not escape appellate review in the name of equity.
  - Absolute priority violation: Highland had not identified a single case in which courts declined review of the treatment of a class of creditor's claims resulting from a cramdown.
- Highland (as we'll get to) is pending before the Supreme Court with respect to scope of exculpation/524(e), but mootness was not raised there
- Plenty for the Supreme Court to consider, once it determines the right case is before it

Releases/Exculpation

- Non-consensual third -party releases have long been controversial, with a circuit split as to whether they are permissible or not
  - Permitted in several circuits, including Second, Third, Fourth, Sixth, Seventh, and Eleventh, although with caution or "in extraordinary cases"
  - Barred in the Fifth, Ninth, and Tenth Circuits
- The Supreme Court took up the issue on appeal from the Second Circuit in *Purdue Pharma* (*Harrington v. Purdue*)
  - Second Circuit joined in authorizing non-consensual third-party releases in limited situations
  - In doing so, reversed District Court's opinion holding that Bankruptcy Code does not permit nonconsensual releases against non-debtors and affirmed the Bankruptcy Court's order confirming the plan
- Bankruptcy professionals are waiting for the Supreme Court to issue an opinion in the *Purdue* appeal
- Until then cases continue, although not quite business as usual
  - Boy Scouts – Supreme Court pause

Releases/Exculpation

- The scope of exculpation provisions is also subject to continuing scrutiny
  - Courts in the Second, Third, Fourth, Sixth, Seventh, Ninth and Eleventh Circuits "allow varying degrees of limited third-party exculpations"
  - The Fifth and the Tenth Circuits take a much narrower view, holding that Bankruptcy Code § 524(e) "categorically bars third party exculpations absent express authority in anther provision of the Bankruptcy Code"

Releases/Exculpation

- The Fifth Circuit had the opportunity to revisit exculpations in their opinion addressing the liquidating plan of *Highland Capital Management LP*
  - The court sharply limited the exculpation provision approved by the Bankruptcy Court, citing its own precedent, *Pacific Lumber*, and Section 524(e)
  - Specifically, the court limited exculpation to: "the debtor, the creditors' committee and its members for conduct within the scope of their duties, 11 U.S.C. § 1103(c), and the trustees within the scope of their duties"
    - For purposes of the *Highland* plan, the Fifth Circuit allowed exculpation of the independent directors, who had acted as trustees, to stand
- The petition for certiorari is still pending

Questions?

Thank you for joining us!

No. 23-124

IN THE

Supreme Court of the United States

WILLIAM K. HARRINGTON,
UNITED STATES TRUSTEE, REGION 2,
Petitioner,

v.

PURDUE PHARMA L.P., ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF OF THE AMERICAN COLLEGE OF BANKRUPTCY AS AMICUS CURIAE IN SUPPORT OF NEITHER PARTY

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INTEREST OF AMICUS CURIAE[1]

The American College of Bankruptcy is an organization of lawyers, judges, academics, and other insolvency professionals, primarily from the United States, who are selected as fellows based on years of achievement in their chosen professions and service to the bar, the community, and their profession. As set forth in its Mission Statement, the College is "dedicated to the enhancement of professionalism, scholarship and service in bankruptcy and insolvency law and practice." Recognizing and respecting the diversity of viewpoints and interests among its fellows, the College will intervene in legal controversies only to advocate for the effective functioning of the bankruptcy system, expressing views that reflect a general consensus among bankruptcy professionals.

Consistent with this mandate, the College does not take a position on whether the court of appeals ruling on review is correct. Rather, this brief seeks to assist the Court by identifying recurring situations where third-party releases are utilized without controversy and are vital to the functioning of the bankruptcy system. The College urges the Court to craft an opinion that—no matter what the disposition of the controversy before it—preserves the use of third-party releases in situations where they have long been recognized as not only appropriate for a chapter

[1] No counsel for a party authored the brief in whole or in part. No party, counsel for a party, or any person other than amicus curiae and its counsel made any monetary contribution intended to fund the preparation or submission of the brief.

11 plan or other settlement of estate claims, but necessary and proper.

The views expressed in this brief are those of the College and do not necessarily reflect the personal views of any fellow of the College or of any firm or organization with which any fellow is affiliated. No judicial fellow participated in any way in the decision to file this brief or in the drafting or review thereof.

INTRODUCTION AND SUMMARY OF ARGUMENT

Bankruptcy's three critical functions are: "[1] the exercise of exclusive jurisdiction over all of the debtor's property, [2] the equitable distribution of that property among the debtor's creditors, and [3] the ultimate discharge that gives the debtor a 'fresh start' by releasing him, her, or it from further liability for old debts." *In re Venoco LLC*, 998 F.3d 94, 104 (3d Cir. 2021) (Ambro, J.) (internal quotation marks omitted). In the context of chapter 11, the latter function is carried out by the Bankruptcy Code's discharge provisions, which can relieve the debtor from prepetition unsecured debt. *See* 11 U.S.C. §§ 524, 1141(d)(1). With the discharge power motivating the creditors, the "[c]hapter 11 reorganization provides a debtor with an opportunity to reduce or extend its debts so its business can achieve long term viability, for instance, by generating profits which will compensate creditors for some or all of any losses resulting from the bankruptcy." *In re Trump Ent. Resorts*, 810 F.3d 161, 173-74 (3d Cir. 2016).

While such discharge of unsecured prepetition debts generally is limited only to the debts of those entities that file for chapter 11 protection, chapter 11 plans frequently encompass limited liability releases for non-debtor third parties. The College submits this brief to caution the Court against categorically barring all manner of third-party releases. Certain types of third-party releases are commonplace, important to the bankruptcy system, and broadly accepted by the courts and practitioners as necessary and proper. In particular, this Court's disposition of the present case should not foreclose or draw into question the availability of 1) consent releases, 2) core exculpation clauses, or 3) bars against assertion by non-debtors of claims that are property of the bankruptcy estate or against estate property. These types of releases are materially different from those in the case under review, and this Court's disposition of the present case (on which the College takes no position) should not draw them into question.

ARGUMENT

Certain types of third-party release are widely accepted within the bankruptcy community as vital to the functioning of the bankruptcy system. In deciding this case, the Court should tailor its opinion so as not to disturb or call into question these three categories of third-party releases:

- **Consent releases**, by a non-debtor "releasor" included in the terms of a chapter 11 plan to which the releasor affirmatively consents.

- **Core exculpation clauses**, limiting potential liability of estate fiduciaries and their professionals for conduct in connection with the chapter 11 case.

- **Protecting property of the bankruptcy estate**. Claims that are property of the estate include, for example, fraudulent transfer claims asserted by the trustee, as well as claims against insurers for coverage under insurance policies administered as an asset of the bankruptcy estate.

I. The Court Should Not Suggest That Consent-Based Releases Of Third-Party Claims Are Impermissible.

In ruling on the present case, this Court should take care not to draw into question the power of a bankruptcy court to include third-party releases effectuated pursuant to a chapter 11 plan when those releases bind releasors who have provided consent following full disclosure.

Regardless of whether ***non***consensual third-party releases are included, chapter 11 provides important, if not essential, tools for implementing mass settlements through negotiations by representatives of all constituencies in a single forum. Any such settlement must be explained to claimants through a court-approved disclosure statement.[2] Voting to approve a

[2] Consistent with the Bankruptcy Code and the requirements of due process, creditors' acceptance or rejection of a chapter 11 plan may be solicited only through a disclosure statement

proposed plan and to give third-party release is subject to court supervision. Such releases can be subject to conditions, with the bankruptcy court determining whether the conditions have been met before the release is effective. For example, a settlement involving third-party releases may be conditioned on not less than a specified percentage of claimants voluntarily giving the release. Claims in a mass tort or other case with hundreds or even hundreds of thousands of claimants can be allowed and valued efficiently and in accordance with uniform standards; indeed, availability of this process can be a substantial incentive for creditors to participate in a voluntary release of claims. Funds from multiple sources can be marshalled and distributed in accordance with the terms of the plan, with quick recourse to the bankruptcy court to resolve any disputes. Given the value of chapter 11 as a forum and process for resolving multiple claims, this Court should tailor its decision on whether nonconsensual third-party releases may be a part of such process so as not to cast doubt on the availability or efficacy of the process itself as applied to consensual releases.

Courts generally agree that third-party releases can properly be effectuated through an affirmative agreement with or consent of the third party affected by the release. *See e.g., Flake v. Schrader-Bridgeport, Int'l, Inc.*, 538 F. App'x 604, 613 (6th Cir. 2013) (Section 524 "limits the effects of a bankruptcy discharge, but does not bar parties from settling their claims.");

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approved by the court as containing adequate information for a typical claimant to make an informed decision about the plan. 11 U.S.C. § 1125.

In re Specialty Equip. Cos., 3 F.3d 1043, 1047 (7th Cir. 1993) ("[C]ourts have found releases that are consensual and non-coercive to be in accord with the strictures of the Bankruptcy Code."); *In re Wool Growers Cent. Storage Co.*, 371 B.R. 768, 775-76 (Bankr. N.D. Tex. 2007) (citing 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, 25 (2006)); *see also* Kyung S. Lee et al., *Revisiting the Propriety of Third-Party Releases of Nondebtors*, 18 Norton J. Bankr. L & Prac. 465, 466 (July/Aug. 2009). Courts routinely allow consensual third-party releases to be included in a chapter 11 plan where the release binds only those creditors who adequately manifested their consent. *In re Specialty Equipment*, 3 F.3d at 1047; *In re Central Jersey Airport Servs., LLC*, 282 B.R. 176, 182 (Bankr. D.N.J. 2002) (voluntary consensual releases are permissible under the Bankruptcy Code); *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 506 (D.N.J. 1997) ("When a release of liability of a nondebtor is a consensual provision, however, … it is no different from any other settlement or contract and does not implicate 11 U.S.C. § 524(e)."); *In re Monroe Well Serv., Inc.*, 80 B.R. 324, 334-35 (Bankr. E.D. Pa. 1987) ("[A] plan provision permitting individual creditors the option of providing a voluntary release to nondebtor plan funders does not violate 11 U.S.C. § 524(e).").[3] Thus, it is no accident that in its

[3] Section 524(e) is agnostic as to third-party releases. By its terms the provision addresses only the effect of a discharge of the debtor ("discharge of a debt of the debtor does not affect the

application to this Court seeking a stay (which triggered the grant of review), the Government was very careful to describe the three circuits barring third-party releases as all dealing with contexts *without* consent of the third parties. Application for Stay 14-15.

Relying on 11 U.S.C. § 1123(b)(6), courts typically allow such consensual third-party releases to be included in a plan because they serve to facilitate final resolution of the case and a fresh start for the debtor, while also enhancing creditors' recoveries. *See In re Arrowmill*, 211 B.R. at 507 ("These settlements by their voluntary nature, serve the interests of all parties involved by promoting reorganization without unfairly burdening other creditors."). In approving such terms, the courts recognize that the third parties and the debtor are engaging in a quasi-contractual arrangement based on the third party's opting to release the covered claims in exchange for receiving property under a plan. *See Food Lion, Inc. v. S.L. Nusbaum*

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liability of any other entity on . . . such debt") and serves to preclude a guarantor, joint tortfeasor, or similarly situated non-debtor from escaping liability by piggybacking on the debtor's discharge. The language of § 524(e) shows no congressional intent to address the permissibility (or not) of an order enjoining creditors' pursuit of claims against non-debtors. Specifying this non-effect of a discharge of the debtor creates no implication, one way or the other, on whether courts may enjoin creditors' pursuit of particular claims against particular non-debtors based on other provisions of the Code. Notably, such release orders are not inherently dependent on discharge of the debtor. Indeed, it is common for corporations to use chapter 11 for a going-concern sale of their business or other liquidation, and in such instances the debtor is ineligible for a discharge. *See* 11 U.S.C. §§ 1141(d)(3), 727(a)(1).

Ins. Agency, Inc., 202 F.3d 223, 228 (4th Cir. 2000) ("[W]hen a release of liability of a nondebtor is a consensual provision … agreed to by the … creditor, it is no different from any other settlement or contract.") (quotation marks omitted).

As this Court has explained: "Adjudication by consent is nothing new. Indeed, '[d]uring the early years of the Republic, federal courts, with the consent of the litigants, regularly referred adjudication of entire disputes to non-Article III referees, masters, or arbitrators, for entry of final judgment in accordance with the referee's report.'" *Wellness Int'l Network, Ltd. v. Sharif*, 575 U.S. 665, 674-75 (2015) (quoting Ralph Brubaker, *The Constitutionality of Litigant Consent to Non-Article III Bankruptcy Adjudications*, 32 Bankr. L. Letter No. 12, p. 6 (Dec. 2012)). *See also*, *Thornton v. Carson*, 11 U.S. (7 Cranch) 596, 597 (1813) (affirming damages awards in two actions that "were referred, by consent under a rule of Court to arbitrators"); *Heckers v. Fowler*, 69 U.S. (2 Wall.) 123, 131 (1864) (observing that the "[p]ractice of referring pending actions under a rule of court, by consent of parties, was well known at common law," and "is now universally regarded … as the proper foundation of judgment"); *Newcomb v. Wood*, 97 U.S. 581, 583 (1878) (recognizing "[t]he power of a court of justice, with the consent of the parties, to appoint arbitrators and refer a case pending before it").

The present case does not draw into question the validity of such consent terms in a chapter 11 plan.[4] In ruling on the dispute before it, however, this Court should not draw into question the validity of such provisions, including (a) releases of claims against a non-debtor pursuant to the debtor's chapter 11 plan, by a creditor who affirmatively opts to give such release as part of the plan voting process, and (b) entry of an injunction barring such creditor from pursuing such claim against the non-debtor.

II. The Court Should Not Suggest That Exculpation Clauses In A Chapter 11 Plan Are Improper.

Exculpatory clauses are typical provisions of a chapter 11 plan intended to limit the liability of estate fiduciaries and other specified parties for certain claims that may be asserted against them based on the work they performed related to the restructuring of the estate. Such limited releases are "'a commonplace provision in Chapter 11 plans.'" *Blixseth v. Credit Suisse*, 961 F.3d 1074, 1085 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021) (quoting *In re PWS Holding Corp.*, 228 F.3d 224, 245 (3d Cir. 2000)). Chapter 11 plans generally limit the liability of estate fiduciaries and their professionals and provide protection for their actions taken in connection with the bankruptcy case. The clauses do not attempt to release the exculpated parties from non-bankruptcy

[4] Indeed, the Government's brief to this Court focuses very intentionally only upon "nonconsensual" releases, using that term almost 30 times, including in the question presented.

acts taken before or after the bankruptcy filing.[5] Moreover, rather than barring such liability completely, an exculpation provision will permit actions for gross negligence or willful misconduct. Consistent with the rationale of this Court in *Barton v. Barbour*, 104 U.S. 126 (1881), such clauses may also provide that any claim against a trustee, professional, or related party arising out of the bankruptcy case only may be brought with permission of the bankruptcy court. *See, e.g., In re Highland Cap. Mgmt., L.P.*, 48 F.4th 419, 435 (5th Cir. 2022), *petition for cert. filed*, (U.S. Jan. 5. 2023) (No. 22-631) (approving a "Gatekeeper Provision" requiring that, "before any lawsuit is filed, the plaintiff must seek the bankruptcy court's approval of the claim as 'colorable'").

The question presented in this case—whether the Bankruptcy Code permits nonconsensual releases of pre-bankruptcy claims—is entirely different from whether an exculpation clause in a chapter 11 plan is an "appropriate provision" pursuant to 11 U.S.C. § 1123(b)(6) (granting the bankruptcy court the power to "include any other appropriate provision not inconsistent with the applicable provisions of this title"). Claims limited by an exculpatory clause are not pre-bankruptcy state-law claims; rather, they arise out of acts and omissions relating to administration of the

[5] What is described here is a core exculpation clause. In some plans the exculpatory clause may be drafted more broadly, to include other parties besides estate fiduciaries and actions taken outside the bankruptcy case. In the present case, this Court has no need to address the proper breadth of such clauses. And the College takes no position here other than that core exculpation clauses are proper and permissible under the Bankruptcy Code.

chapter 11 case. As this Court recognized in *Barton*, placing proper bounds on claims against fiduciaries in an insolvency case falls squarely within the powers and responsibilities of the court administering the case. A person participating in the administration of a debtor's reorganization efforts should not face liability for his or her good-faith efforts in doing so. Exculpation provisions allow the trustee (and other estate representatives) and professionals hired to administer the estate the ability "to engage in the give-and-take of the bankruptcy proceeding without fear of subsequent litigation over any potentially negligent actions in those proceedings." *Blixseth*, 961 F.3d at 1084. Without such exculpation clauses, competent professionals would be deterred from engaging in the bankruptcy process, which would undermine the main purpose of chapter 11—achieving a successful restructuring. American Bankruptcy Institute Commission to Study the Reform of Chapter 11, *2012–2014 Final Report and Recommendations* 251 (2014), http://commission.abi.org/full-report ("[Exculpatory provisions] encourag[e] parties to engage in the process and assist the debtor in achieving a confirmable plan—actions that committees, committee members, other estate representatives and their professionals, and certain parties (such as key lenders) may not be willing to undertake in the face of litigation risk.").

Exculpation clauses are consistent with this Court's decision in *Barton*, *supra*, where this Court recognized that "before suit is brought against a receiver leave of the court by which he was appointed must be obtained." *Barton*, 104 U.S. at 128 (internal citations omitted). The Court explained that absent

leave of the appointing court, another forum would lack subject-matter jurisdiction over a lawsuit because allowing the unauthorized suit to proceed "would have been a usurpation of the powers and duties [that] belonged exclusively to another court." *Id.* at 136. The *Barton* rule is widely understood as "necessary to ensure a consistent and equitable administration of the receivership property" by preventing the gamesmanship that could follow if competing parties were permitted to pursue litigation outside the territorial jurisdiction of the appointing court. *In re VistaCare Grp., LLC*, 678 F.3d 218, 224-25 (3d Cir. 2012) (internal citations omitted). Likewise, if a professional or trustee or other estate representative is to be brought to account for conduct in the administration of the bankruptcy estate, then authority to grant such relief is properly limited to the appointing bankruptcy court.

The Government recognizes that its arguments in the present case, regarding other types of third-party releases, do not implicate exculpation clauses. The Government has not challenged the clause in the Purdue plan that releases estate fiduciaries for actions related to the bankruptcy case.[6] This Court, thus,

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[6] Section 10.6(c) of the Purdue Plan releases "all Holders of Channeled Claims" from "any Claim in connection with, or arising out of, (i) the administration of the Chapter 11 Cases; the negotiation and pursuit of the Restructuring Transactions, the Plan, the Master Disbursement Trust, the Creditor Trusts (including the trust distribution procedures and the other Creditor Trust Documents) and the solicitation of votes with respect to, and confirmation of, the Plan; the funding of the Plan; the occurrence of the Effective Date; the administration of the Plan and

need not address the propriety of such clauses. But the Court also should be careful in its ruling not to include any statement that would cast doubt on the effectiveness of these commonplace and vitally important provisions.

III. The Court Should Not Rule In A Manner That Calls Into Question The Bankruptcy Court's Power Over Property Of The Estate.

The powers of a bankruptcy court and trustee to deal with property of the estate are fundamental elements of the bankruptcy process. Under 11 U.S.C. § 541, filing of the bankruptcy petition creates (with exceptions not pertinent here) an estate including all legal or equitable interests of the debtor in property existing on the filing date. To protect the bankruptcy court's control of estate assets, the filing triggers an automatic stay of "any act to obtain possession of … or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). The Code requires the bankruptcy trustee (or the debtor-in-possession carrying out the same role pursuant to 11 U.S.C. § 1107(a)) to preserve and protect the estate, and to recover property of the estate. *See, e.g.,* 11 U.S.C. §§ 704(a)(1), 1106(a)(1). Performing that statutory role, trustees often bring turnover, fraudulent transfer, and preference actions to recover the property of the estate. 11 U.S.C. §§ 542, 547, 548. As this Court has long recognized, "causes of action" that can be brought by the trustee in the

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the property to be distributed under the Plan; and the wind-up and dissolution of the Liquidating Debtors and the transactions in furtherance of any of the foregoing or (ii) such Holder's participation in the Pending Opioid Actions." J.A. 270.

name of the debtor or estate are "property of the estate." *Celotex Corp. v. Edwards*, 514 U.S. 300, 307 n.5 (1995).

In seeking to recover property of the estate, the trustee, with approval of the bankruptcy court, can, and often does, settle such claims. In doing so, the trustee must have the ability to resolve them completely, including preventing non-debtor parties (typically creditors) from asserting the same claim. In some situations—for example, a trustee's action to collect on an account receivable—a creditor will have no plausible basis for a claim against the defendant. In other instances—for example, a classic corporate derivative claim against directors and officers for breach of fiduciary duty—creditors and/or shareholders may have a plausible basis for asserting the claim outside bankruptcy, but when asserted by the trustee in the context of a bankruptcy case and then settled with the court's approval, the settlement is binding on all creditors and shareholders; their only interest in the settlement proceeds consists of the distribution they may be eligible to receive under the chapter 11 plan on account of their claim or equity interest. *See In re Ionosphere Clubs, Inc.*, 17 F.3d 600, 604 (2d Cir. 1994) ("[T]he claims submitted by the [shareholders] to the bankruptcy court are derivative.... They therefore belong exclusively to the [debtor's] Estate and were extinguished by its settlement of those claims.")

Fraudulent transfer claims present another common situation in which a claim that creditors could assert outside bankruptcy becomes property of the bankruptcy estate. Laws such as the Uniform Voidable Transactions Act (UVTA) and its predecessor, the

Uniform Fraudulent Transfer Act (UFTA),[7] permit creditors outside bankruptcy to recover property that the debtor improperly transferred. The Bankruptcy Code, however, grants the trustee the right to assert on behalf of the bankruptcy estate any state-law fraudulent transfer claim that was or could be asserted by any creditor (*see* 11 U.S.C. § 544(b)(1)), and additionally creates a federal fraudulent transfer cause of action in favor of the trustee (*see* 11 U.S.C. § 548).[8] Thus, the Code vests the power of recovering fraudulent transfers on behalf of all creditors squarely in the hands of the trustee.[9]

When the trustee settles (with the bankruptcy court's approval) a fraudulent transfer claim on behalf of the estate and all of the creditors, the creditors are bound by that settlement and have no right to further pursue their own non-bankruptcy claims to avoid the same transfer. *In re Seven Seas Petroleum, Inc.*, 522 F.3d 575, 589 n.9 (5th Cir. 2008); *Flip M Corp. v. McElhone*, 841 F.2d 531 (4th Cir. 1988) (action for recovery of assets as a fraudulent transfer was for the

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[7] *See, e.g.,* Cal. Civ. Code § 3439.09; Ga. Code Ann. § 18-2-70; Ky. Rev. Stat. Ann. § 378A.005; Mich. Comp. Laws Ann. § 566.37(1)(a); N.Y. Debt. & Cred. Law §§ 270-281.

[8] These provisions overlap but differ in important ways. For example, the statute of limitation under state law (four years under the uniform version of the UVTA or UFTA) is typically longer than the two-year period of § 548, and the definition of avoidable transfers may differ as well.

[9] The Code vests the trustee with other powers that, outside bankruptcy, would be exercised by the individual creditors. For example, § 544(b)(1) provides the trustee with important avoidance powers, such as the ability to set aside unperfected liens, that could be asserted by creditors outside of bankruptcy.

trustee to prosecute, not the creditor injured by the fraudulent transfer). In order to assure finality, courts may—whether as part of a chapter 11 plan or a separate stand-alone settlement of the fraudulent transfer claim—bar creditors from any further action to recover the same transfer. *See In re Bernard L. Madoff Inv. Sec. LLC*, 740 F.3d 81, 95 (2d Cir. 2014) (enjoining fraudulent transfer claims after approving bankruptcy settlement). Other claims of creditors may similarly become property of the estate when bankruptcy is commenced. *See, e.g., In re Tronox Inc.*, 855 F.3d 84, 106-07 (2d Cir. 2017) (trustee has exclusive standing to assert successor liability claims); *In re Emoral, Inc.*, 740 F.3d 875 (3d Cir. 2014) (same).[10]

The Bankruptcy Code expressly provides for claims that are property of the estate to be settled (or further pursued) as part of a chapter 11 plan. 11 U.S.C. § 1123(b)(3). Once court approval of such settlement has been given, whether pursuant to confirmation of a plan or separately, that disposition of estate property is, and must be, enforceable against everyone. Bankruptcy estates must continue to be able to release claims that are property of the estate, and to enforce such release with an injunction against assertion of a released claim by any non-debtor party, including where (but for bankruptcy) the non-debtor

[10] The College does not take a position on whether any particular type of claim should be held to become property of the estate upon commencement of bankruptcy, only that if any claim is property of the estate under applicable law including as it may continue to be developed by the courts, release of such claim by the estate will be binding on third parties, and the release may be backed by a bankruptcy court injunction against the claim being brought in the future.

party has its own cause of action for the released claim.

Protection of estate property also permits entry of injunctions barring creditors from asserting claims directly against an insurer to collect from the debtor's liability policy. It is well settled that insurance policies providing coverage for a debtor's liability to creditors are property of the estate. *In re Stinnett*, 465 F.3d 309, 312 (7th Cir. 2006); *ACandS, Inc. v. Travelers Cas. & Sur. Co.*, 435 F.3d 252, 260 (3d Cir. 2006); *In re Baird*, 567 F.3d 1207 (10th Cir. 2009) (medical malpractice policy property of physician's bankruptcy estate); *In re Vitek*, 51 F.3d 530, 533 (5th Cir. 1995) ("an overwhelming majority of courts have concluded that liability insurance policies fall within § 541(a)(1)'s definition of estate property"); *In re St. Clare's Hosp. & Health Ctr.*, 934 F.2d 15, 18-19 (2d Cir. 1991) ("[a]s this Court has previously ruled … the debtors' rights under its insurance policies are property of a debtor's estate under § 541(a) of the Code"). The proceeds are (or are administered as) property of the estate where insufficient to pay all covered claims. *In re OGA Charters, LLC*, 901 F.3d 599, 604 (5th Cir. 2018). When the estate settles with an insurer over the amount and/or terms of coverage, the settlement is binding on creditors even though, if their claims are covered by the policy, they will under some circumstances have a direct action against the insurer under state law. *See MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 92-93 (2d Cir. 1988) (claims to "collect out of the proceeds of [Debtor's] insurance policies on the basis of [debtor's] conduct" are "inseparable from [debtor's] own insurance coverage and are consequently well

within the Bankruptcy Court's jurisdiction over [debtor's] assets").[11] *See also Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 152 (2009); *In re Titan Energy, Inc.*, 837 F.2d 325, 329 (8th Cir. 1988). Barring direct actions against an insurer can be viewed as a nonconsensual third-party release, but such orders are permissible because they protect the core function of the bankruptcy courts to administer and distribute estate assets.

The Code confers on the trustee the power and duty to bring actions to recover property of the estate and stays creditors from interfering with the trustee's control of estate property for the duration of the case. The bankruptcy court must have the power to effect settlement of those claims, including the power to bar non-debtor actions to recover for or from the estate property that is the subject of the settlement. Absent such power, settlement would not be possible and a core function of the bankruptcy process—to maximize recoveries for creditors from property of the estate—would be thwarted. It is critical for the bankruptcy system that, in disposing of the present case, this Court should take care not to cast doubt on this essential power.

[11] Technically, it is the debtor's rights under insurance policies rather than (necessarily) the policies themselves that constitute property of the estate. The distinction matters where a non-debtor owns or has its own rights under an insurance policy that also covers claims against the debtor.

CONCLUSION

The College respectfully recommends that in ruling on this case, this Court take care not to categorically bar all manner of third-party releases because certain types of third-party releases are permitted under applicable law, important to the bankruptcy system, and long utilized and broadly accepted by courts and petitioners. In particular, the Court's opinion should not foreclose the availability of 1) consent releases, 2) core exculpation clauses, or 3) injunctions protecting property of the estate, including assertion or settlement of claims that are property of the estate and insurance policies of the estate from which creditors might seek to collect their claims by direct action. These types of releases are materially different from those in the case under review, and this Court's disposition of the present case should not draw them into question.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re: GOL LINHAS AÉREAS INTELIGENTES S.A., *et al.*, Debtors.	**FOR PUBLICATION** Case No. 24-10118 (MG) (Jointly Administered)

MEMORANDUM OPINION APPROVING SETTLEMENTS BUT STRIKING THE LOCKUP PROVISIONS FROM STIPULATIONS WITH LESSORS

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A "lockup" agreement binding a significant group of creditors to a debtor's plan that has yet to be filed, negotiated, or even contemplated through a disclosure statement can run afoul of section 1125 of the Bankruptcy Code. The consequences of violating section 1125 can be severe, including "designation" (disregarding) of votes, thus disenfranchising creditors. But not all agreements to support a plan before a disclosure statement is approved are problematic. The Code and caselaw *encourage* debtors and creditors to negotiate the terms of a plan and promise their support, and agreements to do so—often called Plan Support Agreements or Restructuring Support Agreements ("RSAs")—are common. The provision at issue here is an impermissible lockup, not a common RSA.

On March 28, 2024 and April 1, 2024, debtors GOL Linhas Aéreas Inteligentes S.A., *et al.* ("GOL" or the "Debtors") filed four[1] Motions (the "Motions") seeking approval to enter into certain agreements and stipulations (the "Stipulations") with various aircraft lessor counterparties

[1] A fifth motion, with counterparties UMB Bank, N.A. and Zephyrus Capital Aviation Partners 2A Limited, was also filed on March 29, 2024 (ECF Doc. # 389); however, it did not contain the Lockup Provision at issue and is not the subject of this Opinion.

(collectively, the "Counterparties"), all of which included a provision that the Counterparties would support any plan later filed by the Debtors so long as it embodied the terms of the Stipulations (the "Lockup Provision"). The Motions are supported by the declaration of Gregory Ethier ("Ethier Declaration"), annexed as Exhibit C to each Motion.

The Motions are as follows: the *Debtors' Motion for Entry of an Order (i) Approving the Global Restructuring Term Sheet with AerCap Ireland Limited, (ii) Authorizing and Approving the Amendment and Assumption of Certain Aircraft and Engine Leases, (iii) Authorizing Entry into the Definitive Documentation, (iv) Approving the Settlement, and (v) Granting Related Relief* (the "AerCap Motion," ECF Doc. # 379), with Counterparty AerCap Ireland Limited ("AerCap") and certain related parties; and the other three, all titled *Debtors' Motion for Approval of Stipulation and Order Between Debtors and Counterparties Concerning Certain Aircraft and Engines*, made with the following counterparties: the Bank of Utah, N.A. (the "BofU Motion," ECF Doc. # 380); CDB Aviation Lease Finance DAC (the "CDB Motion," ECF Doc. # 382); and SMBC Aviation Capital Ltd. (the "SMBC Motion," ECF Doc. # 395).

The Lockup Provision was the subject of two discovery conferences held on March 28, 2024 and April 4, 2024.[2] The Committee and the United States Trustee (the "UST") both filed objections[3] to the Lockup Provision ("Committee Objection, ECF Doc. # 405; UST Objection, ECF Doc. # 406). The Debtors filed an omnibus reply (the "Reply," ECF Doc. # 443). Obviously aware that the Lockup Provision was problematic under existing caselaw, the Debtors

[2] The Official Committee of Unsecured Creditors (the "Committee) wanted discovery of documents and witnesses in connection with the Lockup Provision. The Debtors opposed discovery and argued that the issues could be resolved as a matter of law. The Court denied discovery but stated that Committee's counsel could cross-examine the Debtors' declarant, Gregory Ethier, during the hearing.

[3] Delta Airlines, Inc. also filed a limited objection and reservation of rights (ECF Doc. # 404) unrelated to the Lockup Provision.

and their counterparties agreed that the Court could approve the Stipulations, but could strike the Lockup Provisions.

The Court held a hearing on the Motions on April 10, 2024 (the "Hearing"). The Ethier Declaration was admitted in evidence without objection, and Mr. Ethier was cross-examined by the Committee's counsel. At the conclusion of the Hearing, the Court approved the economic terms of the Motions. However, the Court ruled that the Lockup Provision was unenforceable and ordered it severed from the Stipulations.[4] The Court stated that an Opinion explaining its ruling would follow. This Opinion explains the Court's reasoning for **SUSTAINING** the Objections of the Committee and the UST.

I. BACKGROUND

A. The Chapter 11 Cases

On January 25, 2024 (the "Petition Date"), each of the Debtors filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code. The Debtors continue to operate their business as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. On February 9, 2024, the UST appointed the Committee. (*See* ECF Doc, # 114)

The Debtors are in the process of negotiating agreements governing their fleet of aircraft on terms consistent with the Debtors' commercial objectives. (AerCap Motion ¶ 10.) Pursuant to the terms of their DIP loan, the Debtors are required to meet certain milestones, including entry into lease modification agreements for 65 aircraft by April 24, 2024, and for 90 aircraft by May 24, 2024. (Committee Objection ¶ 10.) The Motions are a step towards that goal.

[4] Severance of the Lockup Provision while leaving the economic terms in place, if the Court found them unenforceable, was contemplated and explicitly agreed to by the Motions. Orders to this effect have been entered. (*See* ECF Doc. ## 475, 477, 478, 491.)

B. The Motions

The Motions seeks approval of Stipulations resolving certain disputes relating to, among other things, unpaid basic and deferred rent, maintenance reserves, cash collateral, the retention and application of security deposits, and the amendment and assumption of various aircraft and engine leases. No party objected to the economic terms of the Stipulations.

1. The Lockup Provision

The Lockup Provision in the AerCap Motion (reproduced for each Counterparty to the other Motions) reads as follows:

> If a disclosure statement for a Chapter 11 Plan is approved by the Bankruptcy Court, AerCap agrees that, after its vote has been properly solicited, it shall vote (a) to accept the Chapter 11 Plan so long as (i) the Chapter 11 Plan, and a disclosure statement filed by the Debtors (the "Disclosure Statement") (A) is not inconsistent with the terms contained in the Term Sheet, the Definitive Documentation or the Approval Order; (B) no Events of default have occurred and are continuing in respect of any postpetition obligations of the applicable Debtor under the Leases (as amended herein, as applicable), the Definitive Documentation or any other lease ("Other Lease") entered into by Debtors and AerCap; (C) the Chapter 11 Plan provides for the vesting of the Definitive Documentation, including each of the Leases and guarantees, and any Other Lease or other agreement or guarantee in the applicable reorganized Debtor; and (D) the Chapter 11 Plan provides for the exculpation of AerCap; and (ii) (x) as of the effective date of the Chapter 11 Plan, the Debtors' Liquidity shall be no less than US$500,000,000 and (y) as of the effective date of the Chapter 11 Plan, the Projected Leverage Ratio for the calendar year ending 2026 shall be equal to or less than 3.5:1; and (b) against any other plan of reorganization filed by any party other than the Debtors, and shall not, in any material fashion, directly or indirectly support the filing of any such plan of reorganization by any party other than the Debtors.
>
> If any AerCap entity sells, assigns, or otherwise transfers any claim against the Debtors to another person, such person shall execute a joinder to this paragraph prior to such transaction. This Term Sheet is not intended, and shall not be deemed or construed to be, a solicitation for votes in favor of the Chapter 11 Plan for purposes of sections 1125 and 1126 of the Bankruptcy Code or otherwise. The votes of holders of claims and interests in the Chapter 11 Cases will not be solicited until such holders who are entitled to vote on the Chapter 11 Plan have received the Chapter 11 Plan,

> the Disclosure Statement and related ballots, and other solicitation materials or the equivalent. For the avoidance of doubt, AerCap shall not be obligated to support any Chapter 11 Plan filed by the Debtors if such plan, related Disclosure Statement, proposed confirmation order, or other related document (by amendment or otherwise) is not consistent with the terms of the Term Sheet, the leases (as amended herein, as applicable) or the other Definitive Documentation and provided further that AerCap shall be provided with the opportunity (but not the obligation) to participate in any rights offering or similar financing transaction offered in connection with the Chapter 11 Plan to any other group or class of unsecured creditors of the Debtors, provided further that nothing shall prohibit AerCap from filing any objection, action or otherwise seeking any relief or otherwise being heard by the Court on any matter in the Chapter 11 Cases that (in AerCap's sole discretion) impairs AerCap's interests, rights, remedies, or claims in a manner inconsistent with this Term Sheet or the Definitive Documentation. The foregoing provision shall only apply to obligations and claims that arise out of or relate to this Term Sheet and the Definitive Documentation. Furthermore, the foregoing provision shall not be enforceable if the Court determines at the hearing to approve the motion in respect of this Term Sheet that such provision violates applicable law, or declines to approve the motion because of this provision.

(AerCap Motion at 15–16; *see also* CDB Motion, Ex. B, App'x 5; BofU Motion, Ex. B, App'x 4; SMBC Motion, Exs. B-1, B-2, B-3, App'x 7.)

C. The Objections

1. The Committee Objection

The Committee Objection argues that the Court should not approve the Lockup Provision. The Committee alleges that the Lockup Provision (1) is an improper vote solicitation in violation of section 1125(b) of the Bankruptcy Code, orchestrated by the Debtors in the shadow of a potential bid from a competitor, and (2) should be evaluated by a higher standard than the business judgment rule.

a. Alleged 1125(b) Violation

The Committee argues that the Lockup Provision—which requires lessors to support any plan proposed by the Debtors so long as it "reflects the economic substance of the corresponding

Aircraft Agreement and the Debtors meet two seemingly arbitrary financial conditions"—is an impermissible solicitation of creditor votes at this stage, before even a plan term sheet, let alone a disclosure statement, has been filed. (Committee Objection ¶ 17.)

The Committee relies chiefly on *In re SAS AB*, No. 22-10925 (MEW) (Bankr. S.D.N.Y. Sept. 28, 2022), where Judge Wiles *sua sponte* raised concerns about a lockup provision included in a settlement with pilots before a plan was contemplated and ultimately denied the motion in a bench ruling. (*Id.* ¶¶ 18–19.) The Committee also argues that the chapter 11 cases of *In re LATAM Airlines Grp., S.A.*, before Judge Garrity, also support their position. (*Id.* ¶ 20.) There, the debtors had entered into similar lockup agreements with creditors, to which the UST and committee objected under section 1125(b). (*Id.*) Prior to the disclosure statement hearing, the debtors disclaimed the lockups at issue. (*Id.*) Although Judge Garrity did not have to rule on them, the Committee argues that his dicta aligned with Judge Wiles' reasoning on the impermissibility of such lockups. (*Id.*)

The Committee further argues that the conditions which "nominally qualify" the lessors' obligation to vote—the approval of a disclosure statement, a minimum liquidity and leverage ratio—are "meaningless" and "illusory," because the Debtors would not be able to solicit votes to confirm a plan if these supposed "conditions" were not met. (*Id.* ¶¶ 22–23.) Rather, the Committee alleges, the Lockup Provision is a strategic power play by the Debtors to shift bargaining dynamics influenced by (1) transactions with Abra Group Limited ("Abra"), the Debtors' largest secured lender, and (2) a potential purchase bid by Azul Linhas Aéreas Brasileiras S/A ("Azul"), a competitor of the Debtors. (*Id.* ¶¶ 24–25.) The Committee is investigating the Abra transactions, including how they may affect Abra's claims, and argues that the Court should view the Debtors' efforts to create "creeping support" for any plan of their

choosing with "significant caution." (*Id.* ¶ 24.) The Committee further suggests that, in the face of an Azul bid, the Debtors could use the Lockup Provision as "a quasi-poison pill that would thwart any such outside bidders and allow Abra to retain control." (*Id.* ¶ 25.)

Lastly, the Committee argues that each authority relied on by the Debtors is inapplicable or distinguishable. (*Id.* ¶ 26.) Taken together, the Committee argues, they "demonstrate that bankruptcy courts will approve plan support agreements only when the supporting creditors understand what their claim treatment will look like under a chapter 11 plan, either through a disclosure statement or at the very least a term sheet outlining the structure of a plan," which is not the case here. (*Id.*)

b. Argument Against Applying the Business Judgment Standard

Second, the Committee argues that because creditor voting is a "fundamental bankruptcy right," the Court should view any "attempt . . . to impair that right" with "inherent skepticism." (*Id.* ¶ 27.) Rather than evaluate the Motions under the deferential business judgment standard, the Committee argues, the Court should "separately evaluate whether the inclusion of this term is reasonable under the circumstances." (*Id.* ¶ 28.)

The Committee argues that the Lockup Provision is not reasonable for three reasons. *First*, it improperly transfers the lessors' right to vote to the Debtors, thus impairing the rights of other unsecured creditors. (*Id.*) *Second*, the inclusion of the severance language—which allows the Court to strike the Lockup Provision without impacting the economic substance of the deal—demonstrates that, according to the Committee, it is not a critical component of the agreements. (*Id.*) The Committee argues it should be stricken because it does not provide any concrete benefits other than allowing the Debtors to impermissibly exert outsize control over the plan process. (*Id.*) *Third*, the Lockup Provision implicates whether the Debtors negotiated the

settlements in good faith, because "trading of consideration for a plan vote constitutes a bad faith solicitation and runs afoul of section 1126(e) of the Bankruptcy Code." (*Id.* ¶ 29.)

2. The UST Objection

The UST Objection largely echoes the concerns in the Committee Objection, also arguing that the Lockup Provision is an improper solicitation in violation of section 1125(b) that has no meaningful termination provisions, and is distinguishable from permissible plan support agreements. The UST urges the Court to excise the Lockup Provision, allowing the Debtors to keep the economic benefits of their deals and stay on track with their milestones without opening the "floodgates" for the Debtors to "embark on a tactic of strong-arming enough unsecured creditors . . . into supporting an unknown plan." (UST Objection at 2.)

The UST argues that the Debtors are many months away from filing a plan, but the Lockup Provision requires the lessors to support *any* future plan filed by the Debtors without any meaningful termination outs or ability to reconsider their votes after receiving adequate information. (*Id.* at 6–7.) This, the UST argues, is "exactly the harm that Congress sought to prevent by [enacting] Section 1125(b)—i.e., the locked-in vote in favor of a plan based on no information at all." (*Id.* at 7.) Permitting the Lockup Provisions, the UST argues, would (1) disenfranchise creditor constituents, (2) undercut the value and leverage of other creditors in the same class who are not locked-up, and (3) diminish the utility of the Committee and its ability to carry out its fiduciary duties. (*Id.* at 9.)

Permissible agreements, the UST argues, all contained meaningful "outs." (*Id.* at 7.) This one does not. Echoing the Committee's concern, the UST argues that the "hollow" termination outs "offer no protection at all," and are "nothing more than the tautological benefits of the bargains struck," akin to the "meaningless" outs rejected by Judge Wiles in *SAS*. The

liquidity threshold and leverage ratio "make little sense because those are measured as of the effective date of the plan," well after the lessors cast their vote. (*Id.* at 9.)

D. The Reply

The Debtors argue in their Reply that the Lockup Provision *is* permissible, because it is consistent with the caselaw on section 1125(b) and aligns with the provisions regularly approved in this district, and that concerns regarding coercion are unwarranted. They argue that the Lockup Provision is crucial to "delivering the certainty" they need to move these cases forward; without it, the Counterparties would be free to re-trade their deal and "extract additional concessions" with the voting leverage they would gain. (Reply ¶ 4.)

They argue the Lock Provision is permissible under existing caselaw because it is (1) conditioned on the approval of a disclosure statement, feasibility thresholds, fairness to the Counterparty, and on the plan embodying the agreed-upon settlement or stipulation terms; and (2) does not contain a specific performance clause. (*Id.* ¶¶ 12–13.) The Debtors contend that courts in this district regularly approve similar provisions, in cases such as *In re Grupo Aeroméxico, S.A.B. de C.V.*, No. 20-11563 (SCC) (Bankr. S.D.N.Y.); *In re AMR Corp.*, No. 11-15463 (SHL) (Bankr. S.D.N.Y.); and *In re Avianca Holdings S.A.*, No. 20-11133 (MG) (Bankr. S.D.N.Y.).[5] The Debtors further argue that the Counterparties, through their sophistication, have enough information to understand what their claim treatment will look like, though they maintain that this is not the relevant inquiry. (*Id.* ¶ 18.)

Lastly, Debtors refute the notion that there was anything coercive about the negotiations that would justify imposing a high standard of scrutiny. (*Id.* ¶ 20.) The Debtors maintain that the Counterparties, who "hold the keys" to the aircraft required to operate the business, have

[5] None of these cases resulted in written opinions. Only in *Aeroméxico*, where an objection was raised, were the provisions discussed in any detail during the hearing.

ample leverage which they exercised to reach settlements that are "highly favorable" to them. (*Id.* ¶ 21.)

II. LEGAL STANDARD

A. Settlements under Rule 9019

Rule 9019(a) of the Bankruptcy Rules govern the approval of compromises and settlements, and provides as follows:

> On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States Trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.

FED. R. BANKR. P. 9019(a).

"[S]ettlements . . . are favored in bankruptcy and, in fact, encouraged." *In re Chemtura Corp.*, 439 B.R. 561, 595 (Bankr. S.D.N.Y. 2010). However, before approving a settlement, a court must determine that it "is fair and equitable and in the best interests of the estate." *In re Drexel Burnham Lambert Grp., Inc.*, 134 B.R. 493, 496 (Bankr. S.D.N.Y. 1991) (internal quotation marks omitted) (citing *Protective Comm. for Indep. S'holders of TMT Trailer Ferry, Inc. v. Anderson*, 390 U.S. 414, 424 (1968)).

The Second Circuit in *Motorola v. Off. Comm. of Unsecured Creditors (In re Iridium Operating LLC)*, 478 F.3d 452 (2d Cir. 2007), outlined seven factors to be considered by a court in deciding whether to approve a compromise or settlement:

> (1) the balance between the litigation's possibility of success and the settlement's future benefits; (2) the likelihood of complex and protracted litigation, "with its attendant expense, inconvenience, and delay," including the difficulty in collecting on the judgment; (3) "the paramount interests of the creditors," including each affected class's relative benefits "and the degree to which creditors either do not object to or affirmatively support the proposed settlement;" (4) whether other parties in interest support the settlement; (5) the "competency and experience of counsel" supporting, and "[t]he experience and knowledge of the bankruptcy court judge" reviewing,

> the settlement; (6) "the nature and breadth of releases to be obtained by officers and directors;" and (7) "the extent to which the settlement is the product of arm's length bargaining."

Iridium, 478 F.3d at 462.

In considering a proposed settlement, "the bankruptcy court does not substitute its judgment for that of the trustee." *Depo v. Chase Lincoln First Bank, N.A.*, 77 B.R. 381, 384 (N.D.N.Y. 1987), *aff'd sub nom. Depo v. Lincoln Bank*, 863 F.2d 45 (2d Cir. 1988) (citations omitted). The bankruptcy court is not required "to decide the numerous questions of law and fact raised by [objectors] . . . . [R]ather [the Court should] canvas the issues and see whether the settlement falls below the lowest point in the range of reasonableness." *In re Bell & Beckwith*, 77 B.R. 606, 612 (Bankr. N.D. Ohio), *aff'd*, 87 B.R. 472 (N.D. Ohio 1987). Settlements and compromises are "favored in bankruptcy" as they minimize costly litigation and further parties' interests in expediting the administration of the bankruptcy estate. *Myers v. Martin (In re Martin)*, 91 F.3d 389, 393 (3d Cir. 1996) (quoting 10 COLLIER ON BANKRUPTCY ¶ 9019.01 (16th 2019)).

"[W]hile the 'approval of a settlement rests in the Court's sound discretion, the debtor's business judgment should not be ignored.'" *JPMorgan Chase Bank, N.A. v. Charter Communs. Operating, LLC (In re Charter Communs.)*, 419 B.R. 221, 252 (Bankr. S.D.N.Y. 2009) (quoting *In re Stone Barn Manhattan LLC*, 405 B.R. 68, 75 (Bankr. S.D.N.Y 2009)). In addition, the court may "give weight to the informed judgments of the trustee or debtor-in-possession and their counsel that a compromise is fair and equitable." *In re Kerner*, 599 B.R. 751, 756 (Bankr. S.D.N.Y. 2019) (quoting *In re Drexel Burnham Lambert Grp., Inc.*, 134 B.R. at 505). But settlements cannot be allowed to trample on the rights and protections expressly created by section 1125 of the Bankruptcy Code.

B. Solicitation under Section 1125

Section 1125(b) of the Bankruptcy Code governs postpetition disclosure and solicitation. It provides, in relevant part:

> (b) An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets.

11 U.S.C. § 1125(b).

The word "solicitation" is not defined in the Code. *In re Residential Cap., LLC*, No. 12-12020, 2013 WL 3286198, at *19 (Bankr. S.D.N.Y. June 27, 2013) ("*ResCap*"). However, caselaw indicates it should "relate to the formal polling process in which the ballot and disclosure statement are actually presented to creditors with respect to a specific plan." 7 COLLIER ON BANKRUPTCY ¶ 1125.05 (16th 2024).

1. Restructuring Support Agreements

Entering plan or restructuring support agreements has become common practice. 7 COLLIER ON BANKRUPTCY ¶ 1125.05 (16th 2024). The classic RSA outlines the basic elements of a plan and may provide a timetable, thus creating a "base camp" for parties when there is no obvious path to an easily confirmable plan. *See* Douglas G. Baird, *Bankruptcy's Quiet Revolution*, 91 AM. BANKR. L.J. 593, 604 (2017).

While RSAs can be problematic in certain circumstances (for example, the so-called *sub rosa* plan), they are generally approved in this district and others. *See ResCap*, 2013 WL 3286198, at *20. In approving such agreements over objections that they are improper solicitations under section 1125, courts generally consider two policy objectives: *first*, providing

adequate and accurate information to creditors (which, in turn, is influenced by a creditor's relative sophistication), and *second*, encouraging productive negotiations. *See Century Glove, Inc. v. First Am. Bank of New York*, 860 F.2d 94, 101 (3d Cir. 1988) ("'[S]olicitation' must be read narrowly. A broad reading of § 1125 can seriously inhibit free creditor negotiations."); *In re Clamp-All Corp.*, 233 B.R. 198, 208 (Bankr. D. Mass. 1999) (analyzing the purpose of section 1125 as "discourag[ing] the undesirable practice of soliciting acceptance or rejection at a time when creditors and stockholders were too ill-informed to act capably in their own interests") (internal citation and quotation marks omitted).

These considerations are illustrated by a review of three cases considering classic RSAs.

a. Heritage Org.

In *In re Heritage Org., L.L.C.*, 376 B.R. 783 (Bankr. N.D. Tex. 2007), certain creditors had negotiated a term sheet for a liquidating plan, including a support provision, and ultimately jointly filed a disclosure statement and plan reflecting their agreed-upon terms. *Heritage*, 376 B.R. at 787. The court, relying on the narrow definition of solicitation in *Century Glove*, found no improper solicitation had occurred. Based on the underlying purpose of section 1125, to "discourage the undesirable practice of soliciting acceptance or rejection at a time when creditors and stockholders were too ill-informed to act capably in their own interests," the court reasoned that it would be "absurd" to read section 1125(b) to "require a creditor intending to jointly propose a plan to draft a disclosure statement, get it approved, and then mail it to himself before agreeing to vote for it, under penalty of disenfranchisement." *Id.* at 791, 794 (quoting *Clamp-All*, 233 B.R. at 208).

Again, relying on *Century Glove*, the court also considered the objective of fostering open negotiations. *Id.* at 792 ("[W]e find no principled, predicable difference between

negotiation and solicitation of future acceptances . . . the harm [of potentially inadequate disclosure] is further limited by free and open negotiations between creditors.") (citation omitted).

b. Indianapolis Downs

In *In re Indianapolis Downs, LLC.*, 486 B.R. 286 (Bankr. D. Del. 2013), the court reached the same conclusion as *Heritage* under similar facts. Following months of negotiations, the debtors and certain creditors agreed on a fulsome RSA containing broad strokes of a plan, contemplating a market test and, in the alternative, a recapitalization. The court, relying on *Century Glove* and *Heritage*, denied the motion to designate the votes of creditors that signed the RSA based on improper solicitation because it would be "demonstrably inconsistent with the purposes of the bankruptcy code." *Indianapolis Downs*, 486 B.R. at 295.

First, the court reasoned, "Congress intended that creditors have the opportunity to negotiate with debtors and amongst each other; to the extent that those negotiations bear fruit, a narrow construction of 'solicitation' affords these parties the opportunity to memorialize their agreements in a way that allows a Chapter 11 case to move forward." *Id. Second*, "the interests that § 1125 and the disclosure requirements are intended to protect," *i.e.* ill-informed creditors acting against their own interests, were "not at material risk in this case" because the parties were "all sophisticated financial players . . . represented by able and experienced professionals." *Id.*

c. ResCap

Lastly, in *ResCap*, this Court approved a complex and highly negotiated RSA, following months of court-supervised mediation, that "embod[ied] numerous settlements and resolutions of extremely complicated legal and factual disputes that must be resolved to achieve a confirmable plan." *ResCap*, 2013 WL 3286198, at *2. The Court found no improper solicitation because

there were "numerous termination events that allow a party to withdraw," and the agreement to vote was conditioned on the approval of a disclosure statement. *Id.* at *20. Further, the Court relied on the narrow reading of "solicitation" from *Century Glove*, which supports the goal of open negotiation. *Id.* at *19–20.

Taken together, these cases lay out the ingredients of a classic and unquestionably legal RSA: informed creditors knowingly and rationally agreeing to a particular plan structure or features and signing onto an agreement that creates consensus and moves the case forward.

2. Plan Support Provisions

In contrast to classic RSAs, parties sometimes negotiate plan support provisions—or "lockups"—that bind creditors to vote in a particular way. These may crop up as additional features to agreements completely unrelated to the ultimate structure of a plan. Such provisions have elicited mixed reactions from courts.

However, under the majority view, PSAs or lockups are not *per se* improper. In examining the reasoning of courts that have rejected or approved lockups, the key factors that courts consider are (1) whether there is sufficient *information* about the plan itself that creditors were committing to vote for, and (2) whether creditors had meaningful *choice*—either to willingly agree during the negotiation phase, or to rescind based on information that later became available.

a. Cases Disallowing Plan Support Provisions

In *NII Holdings*, Judge Walrath considered a lockup agreement which included specific performance provisions and bound signatories to vote in favor of any plan the debtor proposed. (Oct. 22, 2002 Hr'g Tr., *In re NII Holdings*, Case No. 14-10979 (Bankr. D. Del. 2002).) Judge Walrath ruled that the lockup was an improper solicitation in violation of the Bankruptcy Code,

stating that "to find that obtaining a lock-up agreement in this form is not a solicitation of a vote would mean eviscerating [section 1125] from the Bankruptcy Code completely." (*Id.* at 60:19–23.) Judge Walrath announced a "bright line" rule for her court: no post-petition plan support agreements, period.[6] (*Id.* at 62:1–6.)

In *In re SAS*, Judge Wiles also found a lockup provision, baked into a lease assumption agreement and obligating creditors to vote for *any* plan the debtors might propose, to be a violation of section 1125. (Sept. 28, 2022 Hr'g Tr. at 10:5–9, *In re SAS*, Case No. 22-10925 (Bankr. S.D.N.Y. 2022).) He rejected the attempt to use "the claims process to buy a vote with no particular plan terms and without regard to whether there might be aspect[s] of the plan that the claimant might legitimately have other opinions about," characterizing it as a "naked voting requirement." (*Id.* at 18:1–5, 19:25.)

In distinguishing the lockup from permissible RSAs, Judge Wiles focused on function rather than form: "[T]his is called an RSA, but it's not. It doesn't even remotely resemble anything that I've ever seen as an RSA and certainly is not of the kind of agreement that Courts have allowed under the *Indianapolis Downs* case [or] the *ResCap* case." (*Id.* at 17:20–24.) Judge Wiles also focused on the "purpose of those cases," which was "to allow people to have discussions and negotiations about the structure of a plan and how a Debtor will be capitalized and operated going forward. There's nothing like that in here." (*Id.* at 19:15–18.)

While the *SAS* and the *NII* transcripts illustrate many of the same concerns, and ultimately reach the same conclusion, the distinctiveness of Judge Walrath's approach in the *NII* case—announcing a clear-cut rule prohibiting lockup provisions post-petition—has a broader sweep, seemingly covering even common RSAs which are regularly approved in this district and

[6] While the Court respectfully disagrees that a bright-line prohibition is necessary or appropriate in all circumstances, the result here, invalidating this specific Lockup Provision, does not require adoption of such a rule.

others, which facilitate and foster the negotiation process and information sharing. In contrast, Judge Wiles' analysis in *SAS* recognized the routine approval of RSAs post-petition, differentiating the lockup at issue by emphasizing the absence of crucial information regarding plan terms and the lack of viable options to rescind the agreement. This nuanced approach highlights the importance of transparency and flexibility in such arrangements. The lockups at issue in *SAS* lacked both (1) *any* information about the plan terms, and (2) *any* meaningful outs or options to rescind the agreements, regardless of whether the claimants may later have legitimate objections.

b. Cases Permitting Plan Support Provisions

In *Kellogg Square*, the debtor negotiated a settlement and amended agreement with a utility provider, which included a plan support provision. *In re Kellogg Square P'ship*, 160 B.R. 336, 338–39 (Bankr. D. Minn. 1993). During the negotiations, the debtor provided the utility company with a preliminary draft of its amended disclosure statement. The agreement was formally executed after the disclosure statement was approved. The utility company then voted for the plan, which incorporated the terms of the settlement. Another creditor objected and moved to designate the utility company's vote on the basis that it had been improperly solicited.

In overruling the motion, the court began from the principle that "the law should favor settlements." *Id.* at 339. Following the narrow *Century Glove* reading of "solicitation," it rejected the principle that presentation of a draft disclosure statement violated section 1125(b). *Id.* at 340. Importantly, the court effectively read an "out" into the agreement: "for the purposes of §§ 1125(b) and 1126(e), the act by which the Debtor 'solicited' [the utility company's] vote must be *deemed to have taken place* after the Court approved the amended disclosure statement." *Id.* at 340 (emphasis added). This was because, the court reasoned, the agreement "remained

executory" until the ballot was actually filed. *Id.* If the final disclosure statement had "revealed information that materially bore on [the utility company's] interests" which the debtor had not disclosed, the utility company "would have had a right under general, nonbankruptcy law to *repudiate the agreement via rescission, and then to cast a rejecting ballot*." *Id.* at 339–40 (emphasis added).

Thus, the *Kellogg Square* court shared Judge Wiles' concern about locking creditors into voting for a plan potentially against their interests. The concern in *SAS* was based on a complete lack of information; that same concern also applies to potential misinformation or incomplete information. Recognizing the goal of negotiation among sophisticated parties, the *Kellogg Square* court refused to clog the flow of information by punishing the debtor for sharing a draft disclosure statement. Yet, if the final court-approved disclosure statement had contained surprises or other previously undisclosed information, the *Kellogg Square* court was clear that the utility company would be fully within its rights to rescind the agreement and reject the plan. *Id.* at 340. The *Kellogg Square* lockup was permissible because creditors had (1) the benefit of meaningful *information* from the draft disclosure statement, and (2) the option to *rescind* the agreement if the true plan terms materially differed from what they had agreed to.

In *In re Grupo Aeroméxico*, the committee objected to plan support provisions in claim settlement agreements between the debtors and the creditors. (*See* Nov. 16, 2021 Hr'g. Tr., *In re Grupo Aeroméxico, S.A.B. de C.V., et al.*, Case No. 20-11563 (Bankr. S.D.N.Y. 2021).) Judge Chapman approved the provisions, reasoning that the counterparties were "sophisticated folks who are making a decision about whether to agree to it or not. They've made an economic decision. Presumably, they've analyzed the risk." (*Id.* at 39:22–25.) Further, at the time of the objections, the court had already approved several settlements containing similar provisions

without objections. (*See id.* at 36:18). Judge Chapman found it "significant" that while some settlements contained the provision, some did not, which cut against any "indication . . . of coercion" or that the debtors had conditioned the settlement on the inclusion of the provision. (*Id.* at 36:15–16, 53:17–22.)

While the *SAS* and *Aeroméxico* decisions seem to point in opposite directions, the status of the two cases when the lockups were presented for approval were very different. Judge Wiles denied the *SAS* lockups in September 2022, only a few months after the case had been filed in July 2022. The *SAS* debtors did not file a disclosure statement until 2023. (*See* Case No. 22-10925 ECF Doc. # 1732.) In contrast, the *Aeroméxico* debtors had been in bankruptcy for over a year, and a disclosure statement had been on file for over a month when Judge Chapman approved the lockups in November 2021. (*See* Case No. 20-11563 ECF Doc. # 1807.)

Consequently, Judge Chapman's heavy reliance on the parties' sophistication carried more force as the counterparties had a clearer idea of what they were signing up for. The check was not blank. Judge Chapman concluded that sophisticated parties could weigh risks and assess the Debtors' proposed plan terms to make a calculated and informed decision. Many parties, in fact, exercised this discretion, as reflected by the several agreements that did *not* contain the lockup, demonstrating that creditors also had a *meaningful choice* to reject the provision, even during the negotiation stage. Thus, the court concluded, the *Aeroméxico* lockup was permissible because there was sufficient (1) *information* and (2) evidence of *meaningful choice*, both before and after the disclosure statement was on file.

C. The Business Judgment Rule

The standard used for judicial approval of the use of estate property outside of the ordinary course of business is the business judgment of the debtor. *In re Genco Shipping &*

Trading Ltd., 509 B.R. 455, 464 (Bankr. S.D.N.Y. 2014) (collecting cases). The business judgment rule is deferential, a presumption "shield[ing] corporate decision makers and their decisions from judicial second-guessing when the following elements are present: (1) a business decision, (2) disinterestedness, (3) due care, (4) good faith, and (5) according to some courts and commentators, no abuse of discretion or waste of corporate assets." *In re Integrated Res., Inc.*, 147 B.R. 650, 656 (S.D.N.Y. 1992). Courts are "loath" to interfere with such decisions absent a showing of bad faith, self-interest, or gross negligence. *Id.*

Parties opposing the proposed exercise of a debtor's business judgment have the burden of rebutting the presumption of validity. *Genco Shipping & Trading*, 509 B.R. at 464. If the presumption of validity is rebutted, the court examines the transaction with heightened scrutiny, under the "entire fairness" standard. *In re Innkeepers USA Tr.*, 442 B.R. 227, 231 (Bankr. S.D.N.Y. 2010). This standard examines "whether the process and price of a proposed transaction not only appear fair but are fair and whether fiduciary duties were properly taken into consideration." *Id.*

III. DISCUSSION

While the economic terms of the Motions satisfy the *Iridium* factors and were approved, the Lockup Provision contains neither (1) adequate (or any) information about the plan terms, nor (2) any evidence of meaningful choice. Beyond its effects on the Counterparties, the Lockup Provision risks disenfranchising the voices and votes of smaller creditors. If the Debtors had been permitted to lock in the requisite votes for a cramdown, they would have no incentive to engage with or negotiate with other creditors whose votes they might otherwise have courted. The Debtors' speculative concerns about future renegotiations of terms are not a basis to read section 1125(b) out of the Bankruptcy Code.

In making this ruling, the Court need not evaluate whether the Stipulations should be evaluated under the business judgment or entire fairness standard.

A. The Economic Terms of the Stipulations Are Approved

The Stipulations resolve a host of issues with critical counterparties and move the Debtors towards their DIP milestones. The economic terms embodied in the Stipulations are reasonable, satisfy the *Iridium* factors, and have not generated any objections. Accordingly, the Court has entered orders **APPROVING** the economic terms of the Motions.

B. The UST and Committee Objections to the Lockup Are Sustained

The Lockup Provision is clearly not a classic RSA of the type approved in cases like *Heritage*, *Indianapolis Downs*, or *ResCap*. It does not outline the broad structure or features of a plan. It does not provide a "base camp" around which creditors can rally. It does not facilitate the flow of information.

Rather, the Lockup Provision is a bonus feature, affixed to unrelated stipulations regarding aircraft and engine leases, of the type that reach mixed results under judicial scrutiny. Examining the circumstances, reasoning and outcomes of those cases, the Court should consider (1) whether the Counterparties had adequate information about the terms of a potential plan, and (2) whether the Counterparties had meaningful choice or "outs." The Counterparties had neither. Further, the Court raised concerns at the Hearing that the Debtors may have bought the requisite votes to confirm a plan without input from, or regard for, any other creditors, essentially disenfranchising their votes at a nascent stage in these cases. (*See* Apr. 10, 2024 Hr'g Tr. at 49:12–16.)

The Lockup Provision thus undoes the Bankruptcy Code's careful allocations of creditor rights and ultimately constitutes an improper solicitation in violation of section 1125(b).

1. Counterparties Have No Information About Potential Plan Terms

These cases are in their infancy. Like the *SAS* debtors at the time of Judge Wiles' decision, the Debtors are *months away* from filing a disclosure statement, in contrast to *Aeroméxico*, where a disclosure statement was on file when objections were raised, or *Kellogg Square*, where the debtor had shared a draft disclosure statement. This is also in contrast to *In re AMR Corp.*, No. 11-15463 (SHL) (Bankr. S.D.N.Y.), which the Debtors cite in their Reply to bolster their argument for the Lockup Provision because no disclosure statement was yet on file. (*See* Reply ¶ 15.) There, an agreement containing a plan support provision was approved the same day as the disclosure statement; however, the provision was "based on the [plan] term sheet," and counterparties had been "been in daily contact . . . turning drafts of the plan, turning drafts of the disclosure statement," which contained anticipated recoveries and projected stock prices. (June 4, 2013 Hr'g Tr. at 10:3–12, 10:17–18, *In re AMR Corp.*, No. 11-15463 (Bankr. S.D.N.Y.).) There was thus clearly sufficient information in that case.

The Court here is faced with a binary choice framed by the Debtors: approve the Stipulations with the Lockup Provision intact, or approve them with the Lockup Provision excised. The Court rejects the former and embraces the latter. The Court declines to opine on the exact amount of information or stage of a case at which a plan support provision becomes permissible (and has stated on the record that citing to uncontested orders entered in other cases is generally unpersuasive). However, here, the lack of *any* adequate information about plan terms clearly runs head-on into the purpose and goals of section 1125(b).

2. Counterparties Have No Meaningful "Outs"

The main concern articulated by Judge Wiles—that the debtors were attempting to extract a blank check for any plan they proposed, with no meaningful outs—applies with equal force here.

The Lockup Provision mandates votes for *any* plan the Debtors may later propose, so long as it embodies the terms of the Stipulations. These terms are only part of what will certainly be a broader plan structure. The Lockup Provision contains no meaningful "outs" for creditors to void the blank check they are writing. As the Committee and UST point out, the "conditions" to the agreement are hollow and illusory, or tautological results of being in chapter 11. The Lockup Provision provides that a disclosure statement must be approved by the Court: this is a requirement of the Bankruptcy Code, not a termination provision. The Lockup Provision requires the Debtors to hit certain liquidity and leverage ratios; but these ratios are measured as of the *effective* date, after a plan has been solicited, confirmed, and implemented. Further, the agreement only requires the Debtors to list them in the disclosure statement as targets or projections.[7] However, if it turns out that these goals were projected but not hit, there would be no way to unscramble the egg. Further, setting aside the logistical impossibility, counterparties may have legitimate objections based on other grounds besides liquidity and leverage. Yet the Lockup Provision snuffs out any ability to vote accordingly.

As the Court remarked during the April 2, 2024 discovery conference, there is a crucial difference between agreeing that settlement terms *must be included in any plan*, and agreeing to vote for *any plan that includes* the settlement terms. (*See* Apr. 2, 2024 Hr'g. Tr. 25:24–25, 26:1–

[7] (*See* Apr. 10, 2024 Hr'g Tr. at 49:12–16 (LeBlanc) (stating that if the disclosure statement "says [the Debtors are] going to have 400 million dollars of liquidity," *i.e.* does not *project* that the targets will be met, counterparties would be released from the Lockup Provision.)

5.) The Lockup Provision requires the latter; it ties the creditors' hands, requiring their vote without regard for any legitimate concerns they may have with the plan (unrelated to the terms of the Stipulations) and without any ability to rescind or terminate the agreement.

Clearly, there are no meaningful "outs." Without any information about plan terms, or any history of similar agreements without the Lockup Provision to demonstrate any meaningful choice, the Lockup Provision fails on the second prong of consideration.

C. Sophistication is Relevant, but Is Not *Carte Blanche* to Circumvent Section 1125

Creditor sophistication is a highly relevant factor in assessing the permissibility of plan support provisions. However, no level of sophistication allows parties to circumvent the Bankruptcy Code or use its provisions as bargaining chips. *Cf. Czyzewski v. Jevic Holding Corp.*, 580 U.S. 451, 467–468 (2017) (disapproving of attempts to make an "end run" around or "short-circuit" the requirements and safeguards of chapter 11). A creditor's sophistication is not an excuse to strip away provisions of the Bankruptcy Code which protect it; on the flipside, neither is it a golden ticket to strike a creative deal that may trample the statutory rights of *other* creditors.

1. Section 1125 Protects Even Sophisticated Counterparties

Relying on sophistication *alone*, in the absence of any information or evidence of meaningful choice, could lead to an undesirable result even when assuming perfect rationality of every actor. Though each counterparty may wish to avoid the situation where the debtor has complete control over their class of votes, each would wish to retain the benefit of *their* bargain. They would thus face a coordination game with other members of their class where each would rationally choose to sign the deal, lest they be left out in the cold. The result would be a "tragedy of the commons": the debtor achieves complete control over a class, a result which each

counterparty may have been able to foresee, but which none would rationally cede their own bargain to avoid. Section 1125(b) guards against this result. By tying the hands of all parties, the Code solves the coordination game that could exist—even among sophisticated parties—thus serving as a bulwark against the tragedy of the commons.

2. Section 1125 Protects Unsophisticated Parties

On the flipside, creditor sophistication is not a free pass to strike a deal that runs roughshod over the rights of others. The Lockup Provision would grant the Debtors the votes needed to propose and confirm essentially any plan they wished as long as the Stipulation terms are included in the plan, obviating the need to deal with any other, smaller creditors. It would thus taint the voting process by effectively silencing the votes of all creditors besides the Counterparties.

D. Speculative Concerns Are Not a Basis to Ignore 1125

In the Reply and during the Hearing, the Debtors argued that the Lockup Provision was essential to ensure "certainty" that their agreements with the Counterparties were "the full, final, and complete deal." (Reply ¶ 4.) They expressed concerns that without the Lockup Provision, they would "have no assurance that additional concessions will not be demanded" by the Counterparties (or a successor in interest) in exchange for their vote. (*Id.*; *see also* Apr. 10, 2024 Hr'g Tr. at 60:7–10 (Leblanc) ("Half the bets are off . . . . The other half of the bet is how do you use the leverage that you have in the plan negotiation process.").)

This is a speculative and hypothetical concern. When questioned at the Hearing about any cases where this had occurred, counsel for the Debtors was unable to "point [the Court] to a circumstance in which those facts have arisen." (Apr. 10, 2024 Hr'g Tr. at 56:7–13.) Counsel for the Committee was similarly unaware of any such cases. (*See id.* at 89:13–16 ("The Court: Is

there any decisional law where a group of creditors that have settled during the case have tried to re-trade the case before a plan is voted on? Mr. Miller: No. I have none.").)

The Stipulations without the lockups have been approved. If the Counterparties seek to back out or renegotiate the agreements, the law provides the Debtors with remedies to enforce them.

Even assuming this concern of re-trading the deal was as pressing and imminent as the Debtors contend, it does not erase section 1125(b). The Court cannot waive compliance with the Bankruptcy Code to provide the Debtors with more "certainty" or "finality" in their deal. These speculative concerns do not trump the statute.

IV. CONCLUSION

For the reasons explained above, the economic terms of the Motions are **APPROVED**, and the UST and Committee Objections to the Lockup Provision are **SUSTAINED**.

The Orders approving the Stipulations without the Lockup Provision have already been entered.

Dated: April 22, 2024
New York, New York

Martin Glenn

MARTIN GLENN
Chief United States Bankruptcy Judge

Case: 21-10449 Document: 00516462923 Page: 1 Date Filed: 09/07/2022

United States Court of Appeals for the Fifth Circuit

United States Court of Appeals
Fifth Circuit
FILED
September 7, 2022
Lyle W. Cayce
Clerk

No. 21-10449

In the Matter of: Highland Capital Management, L.P.,

Debtor,

NexPoint Advisors, L.P.; Highland Capital Management Fund Advisors, L.P.; Highland Income Fund; NexPoint Strategic Opportunities Fund; Highland Global Allocation Fund; NexPoint Capital, Incorporated; James Dondero; The Dugaboy Investment Trust; Get Good Trust,

Appellants,

versus

Highland Capital Management, L.P.,

Appellee.

Appeal from the United States Bankruptcy Court
for the Northern District of Texas
USDC No. 19-34054
USDC No. 3:21-CV-538

Before Wiener, Graves, and Duncan, *Circuit Judges*.

ON PETITION FOR REHEARING

No. 21-10449

STUART KYLE DUNCAN, *Circuit Judge*:

The petition for panel rehearing is GRANTED. We withdraw our previous opinion, reported at 2022 WL 3571094, and substitute the following:

Highland Capital Management, L.P., a Dallas-based investment firm, managed billion-dollar, publicly traded investment portfolios for nearly three decades. By 2019, however, myriad unpaid judgments and liabilities forced Highland Capital to file for Chapter 11 bankruptcy. This provoked a nasty breakup between Highland Capital and its co-founder James Dondero. Under those trying circumstances, the bankruptcy court successfully mediated with the largest creditors and ultimately confirmed a reorganization plan amenable to most of the remaining creditors.

Dondero and other creditors unsuccessfully objected to the confirmation order and then sought review in this court. In turn, Highland Capital moved to dismiss their appeal as equitably moot. First, we hold that equitable mootness does not bar our review of any claim. Second, we affirm the confirmation order in large part. We reverse only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e), strike those few parties from the plan's exculpation, and affirm on all remaining grounds.

I. BACKGROUND

A. Parties

In 1993, Mark Okada and appellant James Dondero co-founded Highland Capital Management, L.P. ("Highland Capital") in Dallas. Highland Capital managed portfolios and assets for other investment advisers and funds through a complex of entities under the Highland umbrella. Highland Capital's ownership-interest holders included Hunter Mountain Investment Trust (99.5%); appellant The Dugaboy Investment

Trust, Dondero's family trust (0.1866%);[1] Okada, personally and through trusts (0.0627%); and Strand Advisors, Inc. (0.25%), the only general partner, which Dondero wholly owned.

Dondero also manages two of Highland Capital's clients—appellants Highland Capital Management Fund Advisors, L.P. and NexPoint Advisors, L.P. (the "Advisors"). Both the Advisors and Highland Capital serviced and advised billion-dollar, publicly traded investment funds for appellants Highland Income Fund, NexPoint Strategic Opportunities Fund, Highland Global Allocation Fund, and NexPoint Capital, Inc. (collectively, the "Funds"), among others. For example, on behalf of the Funds, Highland Capital managed certain investment vehicles known as collateral loan obligations ("CLOs") under individualized servicing agreements.

B. Bankruptcy Proceedings

Strapped with a series of unpaid judgments, Highland Capital filed for Chapter 11 bankruptcy in the District of Delaware in October 2019. The creditors included Highland Capital's interest holders, business affiliates, contractors, former partners, employees, defrauded investors, and unpaid law firms. Among those creditors, the Office of the United States Trustee appointed a four-member Unsecured Creditors' Committee (the "Committee").[2] *See* 11 U.S.C. § 1102(a)(1), (b)(1). Throughout the

[1] The Dugaboy Investment Trust appeals alongside Dondero's other family trust Get Good Trust (collectively, the "Trusts").

[2] First, Redeemer Committee of the Highland Crusader Fund had obtained a $191 million arbitration award after a decade of litigation against Highland Capital. Second, Acis Capital Management, L.P. and Acis Capital Management GP, LLC had sued Highland Capital after facing an adverse $8 million arbitration award, arising in part from its now-extinguished affiliation. Third, UBS Securities LLC and UBS AG London Branch had received a $1 billion judgment against Highland Capital following a 2019 bench trial in New

bankruptcy proceedings, the Committee investigated Highland Capital's past and current operations, oversaw its continuing operations, and negotiated the reorganization plan. *See id.* § 1103(c). Upon the Committee's request, the court transferred the case to the Northern District of Texas in December 2019.

Highland Capital's reorganization did not proceed under the governance of a traditional Chapter 11 trustee. Instead, the Committee reached a corporate governance settlement agreement to displace Dondero, which the bankruptcy court approved in January 2020. Under the agreed order, Dondero stepped down as director and officer of Highland Capital and Strand to be an unpaid portfolio manager and "agreed not to cause any Related Entity . . . to terminate any agreements" with Highland Capital. The Committee selected a board of three independent directors to act as a quasi-trustee and to govern Strand and Highland Capital: James Seery Jr., John Dubel, and retired Bankruptcy Judge Russell Nelms (collectively, the "Independent Directors"). The order also barred any claim against the Independent Directors in their official roles without the bankruptcy court's authorizing the claim as a "colorable claim[] of willful misconduct or gross negligence." Six months later, at the behest of the creditors, the bankruptcy court appointed Seery as Highland Capital's Chief Executive Officer, Chief Restructuring Officer, and Foreign Representative. The order contained an identical bar on claims against Seery acting in these roles. Neither order was appealed.

Throughout summer 2020, Dondero proposed several reorganization plans, each opposed by the Committee and the Independent Directors.

York. Fourth, discovery vendor Meta-E Discovery had $779,000 in unpaid invoices. The Committee members are not parties on appeal.

Unpersuaded by Dondero, the Committee and Independent Directors negotiated their own plan. When Dondero's plans failed, he and other creditors began to frustrate the proceedings by objecting to settlements, appealing orders, seeking writs of mandamus, interfering with Highland Capital's management, threatening employees, and canceling trades between Highland Capital and its clients. *See Highland Cap. Mgmt., L.P. v. Dondero (In re Highland Cap. Mgmt., L.P.)*, Ch. 11 Case No. 19-34054-SGJ11, Adv. No. 20-03190-SGJ11, 2021 WL 2326350, at *1, *26 (Bankr. N.D. Tex. June 7, 2021) (holding Dondero in civil contempt, sanctioning him $100,000, and comparing this case to a "nasty divorce"). In Seery's words, Dondero wanted to "burn the place down" because he did not get his way. The Independent Directors insisted Dondero resign from Highland Capital, which he did in October 2020.

Highland Capital, meanwhile, proceeded toward confirmation of its reorganization plan—the Fifth Amended Plan of Reorganization of Highland Capital Management, L.P. (the "Plan"). In August 2020, the Independent Directors filed the Plan and an accompanying disclosure statement with the support of the Committee. *See* 11 U.S.C. §§ 1121, 1125. The bankruptcy court approved the statement as well as proposed notice and voting procedures for creditors, teeing up confirmation. Leading up to the confirmation hearing, the Advisors and the Funds asked the court to bar Highland Capital from trading or disposing of CLO assets pending confirmation. The bankruptcy court denied the request, and Highland Capital declined to voluntarily abstain and continued to manage the CLO assets.

Before confirmation, Dondero and other creditors (including several non-appellants) filed over a dozen objections to the Plan. Like Dondero, the United States Trustee primarily objected to the Plan's exculpation of certain non-debtors as unlawful. Highland Capital voluntarily modified the Plan to resolve six such objections. The Plan proposed to create eleven classes of

creditors and equity holders and three classes of administrative claimants. *See* 11 U.S.C. § 1122. Of the voting-eligible classes, classes 2, 7, and 9 voted to accept the Plan while classes 8, 10, and 11 voted to reject it.

C. Reorganization Plan

The Plan works like this: It dissolves the Committee, and creates four entities—the Claimant Trust, the Reorganized Debtor, HCMLP GP LLC,[3] and the Litigation Sub-Trust. Administered by its trustee Seery, the Claimant Trust "wind[s]-down" Highland Capital's estate over approximately three years by liquidating its assets and issuing distributions to class-8 and -9 claimants as trust beneficiaries. Highland Capital vests its ongoing servicing agreements with the Reorganized Debtor, which "among other things" continues to manage the CLOs and other investment portfolios. The Reorganized Debtor's only general partner is HCMLP GP LLC. And the Litigation Sub-Trust resolves pending claims against Highland Capital under the direction of its trustee Marc Kirschner.

The whole operation is overseen by a Claimant Trust Oversight Board (the "Oversight Board") comprised of four creditor representatives and one restructuring advisor. The Claimant Trust wholly owns the limited partnership interests in the Reorganized Debtor, HCMLP GP LLC, and the Litigation Sub-Trust. The Claimant Trust (and its interests) will dissolve either at the soonest of three years after the effective date (August 2024) or (1) when it is unlikely to obtain additional proceeds to justify further action, (2) all claims and objections are resolved, (3) all distributions are made, and (4) the Reorganized Debtor is dissolved.

[3] The Plan calls this entity "New GP LLC," but according to the motion to dismiss as equitably moot, the new general partner was later named HCMLP GP LLC. For the sake of clarity, we use HCMLP GP LLC.

Anticipating Dondero's continued litigiousness, the Plan shields Highland Capital and bankruptcy participants from lawsuits through an exculpation provision, which is enforced by an injunction and a gatekeeper provision (collectively, "protection provisions"). The protection provisions extend to nearly all bankruptcy participants: Highland Capital and its employees and CEO; Strand; the Independent Directors; the Committee; the successor entities and Oversight Board; professionals retained in this case; and all "Related Persons"[4] (collectively, "protected parties").[5]

The Plan exculpates the protected parties from claims based on any conduct "in connection with or arising out of" (1) the filing and administration of the case, (2) the negotiation and solicitation of votes preceding the Plan, (3) the consummation, implementation, and funding of the Plan, (4) the offer, issuance, and distribution of securities under the Plan before or after the filing of the bankruptcy, and (5) any related negotiations, transactions, and documentation. But it excludes "acts or omissions that constitute bad faith, fraud, gross negligence, criminal misconduct, or willful misconduct" *and* actions by Strand and its employees predating the appointment of the Independent Directors.

Under the Plan, bankruptcy participants are enjoined "from taking any actions to interfere with the implementation or consummation of the

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[4] The Plan generously defines "Related Persons" to include all former, present, and future officers, directors, employees, managers, members, financial advisors, attorneys, accountants, investment bankers, consultants, professionals, advisors, shareholders, principals, partners, heirs, agents, other representatives, subsidiaries, divisions, and managing companies.

[5] The Plan expressly excludes from the protections Dondero and Okada; NexPoint Advisors, L.P.; Highland Capital Management Fund Advisors, L.P; their subsidiaries, managed entities, managed entities, and members; and the Dugaboy Investment Trust and its trustees, among others.

Plan" or filing any claim related to the Plan or proceeding. Should a party seek to bring a claim against any of the protected parties, it must go to the bankruptcy court to "first determin[e], after notice and a hearing, that such claim or cause of action represents a colorable claim of any kind." Only then may the bankruptcy court "specifically authoriz[e]" the party to bring the claim. The Plan reserves for the bankruptcy court the "sole and exclusive jurisdiction to determine whether a claim or cause of action is colorable" and then to adjudicate the claim if the court has jurisdiction over the merits.

D. Confirmation Order

At a February 2021 hearing, the bankruptcy court confirmed the Plan from the bench over several remaining objections. *See* FED R. BANKR. P. 3017–18; 11 U.S.C. §§ 1126, 1128, 1129. In its later-written decision, the bankruptcy court observed that Highland Capital's bankruptcy was "not a garden variety chapter 11 case." The type of debtor, the reason for the bankruptcy filing, the kinds of creditor claims, the corporate governance structure, the unusual success of the mediation efforts, and the small economic interests of the current objectors all make this case unique.

The confirmation order criticized Dondero's behavior before and during the bankruptcy proceedings. The court could not "help but wonder" if Highland Capital's deficit "was necessitated because of enormous litigation fees and expenses incurred" due to Highland Capital's "culture of litigation." Recounting Highland Capital's litigation history, it deduced that Dondero is a "serial litigator." It reasoned that, while "Dondero wants his company back," this "is not a good faith basis to lob objections to the Plan." It attributed Dondero's bad faith to the Advisors, the Trusts, and the Funds, given the "remoteness of their economic interests." For example, the bankruptcy court "was not convinced of the[] [Funds'] independence" from Dondero because the Funds' board members did not testify and had

"engaged with the Highland complex for many years." And so the bankruptcy court "consider[ed] them all to be marching pursuant to the orders of Mr. Dondero." The court, meanwhile, applauded the members of the Committee for their "wills of steel" for fighting "hard before and during this Chapter 11 Case" and "represent[ing] their constituency . . . extremely well."

On the merits of the Plan, the bankruptcy court again approved the Plan's voting and confirmation procedures as well as the fairness of the Plan's classes. *See* 11 U.S.C. §§ 1122, 1125(a)–(c). The court held the Plan complied with the statutory requirements for confirmation. *See id.* §§ 1123(a)(1)–(7), 1129(a)(1)–(7), (9)–(13). Because classes 8, 10, and 11 had voted to reject the Plan, it was confirmable only by cramdown.[6] *See id.* § 1129(b). The bankruptcy court found that the Plan treated the dissenting classes fairly and equitably and satisfied the absolute-priority rule, so the Plan was confirmable. *See id.* § 1129(b)(2)(B)–(C). The court also concluded that the protection provisions were fair, equitable, and reasonable, as well as "integral elements" of the Plan under the circumstances, and were within both the court's jurisdiction and authority. The court confirmed the Plan as proposed and discharged Highland Capital's debts. *Id.* § 1141(d)(1). After confirmation and satisfaction of several conditions precedent, the Plan took effect August 11, 2021.

[6] The bankruptcy court must proceed by nonconsensual confirmation, or "cramdown," 11 U.S.C. § 1129(b), when a class of unsecured creditors rejects a Chapter 11 reorganization plan, *id.* § 1129(a)(8), but at least one impaired class accepts it, *id.* § 1129(a)(10). A cramdown requires that the plan be "fair and equitable" to dissenting classes and satisfy the absolute priority rule—that is, dissenting classes are paid in full before any junior class can retain any property. *Id.* § 1129(b)(2)(B); *see Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 441–42 (1999).

E. The Appeal

Dondero, the Advisors, the Funds, and the Trusts (collectively, "Appellants") timely appealed, objecting to the Plan's legality and some of the bankruptcy court's factual findings.[7] Together with Highland Capital, Appellants moved to directly appeal the confirmation order to this court, which the bankruptcy court granted. *See* 28 U.S.C. § 158(d). A motions panel certified and consolidated the direct appeals. *See ibid.* Both the bankruptcy court and the motions panel declined to stay the Plan's confirmation pending appeal. Given the Plan's substantial consummation since its confirmation, Highland Capital moved to dismiss the appeal as equitably moot, a motion the panel ordered carried with the case.

* * *

We first consider equitable mootness and decline to invoke it here. We then turn to the merits, conclude the Plan exculpates certain non-debtors beyond the bankruptcy court's authority, and affirm in all other respects.

II. Standard of Review

A confirmation order is an appealable final order, over which we have jurisdiction. *Bullard v. Blue Hills Bank*, 575 U.S. 496, 502 (2015); *see* 28 U.S.C. §§ 158(d), 1291. This court reviews a bankruptcy court's factual findings for clear error and legal conclusions *de novo*. *Evolve Fed. Credit Union v. Barragan-Flores (In re Barragan-Flores)*, 984 F.3d 471, 473 (5th Cir. 2021) (citation omitted).

[7] The Trusts adopt the Funds' and the Advisors' briefs in full, and Dondero adopts the Funds' brief in full and the Advisors' brief in part. Fed. R. App. P. 28(i).

III. Equitable Mootness

Highland Capital moved to dismiss this appeal as equitably moot. It argues we should abstain from appellate review because clawing back the implemented Plan "would generate untold chaos." We disagree and deny the motion.

The judge-made doctrine of equitable mootness allows appellate courts to abstain from reviewing bankruptcy orders confirming "complex plans whose implementation has substantial secondary effects." *New Indus., Inc. v. Byman (In re Sneed Shipbuilding, Inc.)*, 916 F.3d 405, 409 (5th Cir. 2019) (citing *In re Trib. Media Co.*, 799 F.3d 272, 274, 281 (3d Cir. 2015)). It seeks to balance "the equitable considerations of finality and good faith reliance on a judgment" and "the right of a party to seek review of a bankruptcy order adversely affecting him." *In re Manges*, 29 F.3d 1034, 1039 (5th Cir. 1994) (quoting *First Union Real Estate Equity & Mortg. Inv. v. Club Assocs. (In re Club Assocs.)*, 956 F.3d 1065, 1069 (11th Cir. 1992)); *see In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008); *see also* 7 Collier on Bankruptcy ¶ 1129.09 (16th ed.), LexisNexis (database updated June 2022) (observing "the equitable mootness doctrine is embraced in every circuit").[8]

This court uses equitable mootness as a "scalpel rather than an axe," applying it claim-by-claim, instead of appeal-by-appeal. *In re Pac. Lumber*

[8] The doctrine's atextual balancing act has been criticized. *See In re Pac. Lumber Co.*, 584 F.3d 229, 240 (5th Cir. 2009) ("Despite its apparent virtues, equitable mootness is a judicial anomaly."); *In re One2One Commc'ns, LLC*, 805 F.3d 428, 438–54 (3rd Cir. 2015) (Krause, J., concurring); *In re UNR Indus., Inc.*, 20 F.3d 766, 769 (7th Cir. 1994) (banishing the term "equitable mootness" as a misnomer); *In re Cont'l Airlines*, 91 F.3d 553, 569 (3d Cir. 1996) (en banc) (Alito, J., dissenting); *see also* Bruce A. Markell, *The Needs of the Many: Equitable Mootness' Pernicious Effects*, 93 Am. Bankr. L.J. 377, 393–96 (2019) (addressing the varying applications between circuits). *But see In re Trib. Media*, 799 F.3d at 287–88 (Ambro, J., concurring) (highlighting some benefits of the equitable mootness doctrine).

Co.(Pacific Lumber), 584 F.3d 229, 240–41 (5th Cir. 2009). For each claim, we analyze three factors: "(i) whether a stay has been obtained, (ii) whether the plan has been 'substantially consummated,' and (iii) whether the relief requested would affect either the rights of parties not before the court or the success of the plan." *In re Manges*, 29 F.3d at 1039 (citing *In re Block Shim Dev. Co.*, 939 F.2d 289, 291 (5th Cir. 1991); and *Cleveland, Barrios, Kingsdorf & Casteix v. Thibaut*, 166 B.R. 281, 286 (E.D. La. 1994)); *see also, e.g.*, *In re Blast Energy Servs.*, 593 F.3d 418, 424–25 (5th Cir. 2010); *In re Ultra Petroleum Corp.*, No. 21-20049, 2022 WL 989389, at *5 (5th Cir. Apr. 1, 2022). No one factor is dispositive. *See In re Manges*, 29 F.3d at 1039.

Here, the bankruptcy court and this court declined to stay the Plan pending appeal, and it took effect August 11, 2021. Given the months of progress, no party meaningfully argues the Plan has not been substantially consummated.[9] *See Pacific Lumber*, 584 F.3d at 242 (observing "consummation includes transferring all or substantially all of the property

[9] Since the Plan's effectuation, Highland Capital paid $2.2 million in claims to a committee member and $525,000 in "cure payments" to other counterparties. The independent directors resigned. The Reorganized Debtor, the Claimant Trust, HCMLP GP LLC, and the Litigation Sub-Trust were created and organized in accordance with the Plan. The bankruptcy court appointed the Oversight Board members, the Litigation Sub-Trust trustee, and the Claimant Trust trustee. Highland Capital assumed certain service contracts, including management of twenty CLOs with approximately $700 million in assets, and transferred its assets and estate claims to the successor entities. Highland Capital's pre-petition partnership interests were cancelled and cease to exist. A third party, Blue Torch Capital, infused $45 million in exit financing, fully guaranteed by the Reorganized Debtor, its operating subsidiaries, the Claimant Trust, and most of their assets. From the exit financing, an Indemnity Trust was created to indemnify claims that arise against the Reorganized Debtor, Claimant Trust, Ligation Sub-Trust, Claimant Trustee, Litigation Trustee, or Oversight Board members. The lone class-1 creditor withdrew its claim against Highland Capital. The lone class-2 creditor has been fully paid approximately $500,000 and issued a note of $5.2 million secured by $23 million of the Reorganized Debtor's assets. Classes 3 and 4 have been paid $165,412. Class 7 has received $5.1 million in distributions from the Claimant Trust, totaling 77% of class-7 claims filed.

covered by the plan, the assumption of business by the debtors' successors, and the commencement of plan distributions" (citing 11 U.S.C. § 1141; and *In re Manges*, 29 F.3d at 1041 n.10)). But that alone does not trigger equitable mootness. *See In re SCOPAC*, 624 F.3d 274, 281–82 (5th Cir. 2010). Instead, for each claim, the inquiry turns on whether the court can craft relief for that claim that would not have significant adverse consequences to the reorganization. Highland Capital highlights four possible disruptions: (1) the unraveling of the Claimant Trust and its entities, (2) the expense of disgorging disbursements, (3) the threat of defaulting on exit-financing loans, and (4) the exposure to vexatious litigation.

Each party first suggests its own all-or-nothing equitable mootness applications. To Highland Capital, Appellants' broad requested remedy with only a minor economic stake demands mooting the entire appeal. To Appellants, the type of reorganization plan categorially bars equitable mootness, or, alternatively, Highland Capital's joining the motion to certify the appeal estops it from asserting equitable mootness. These arguments are unpersuasive and foreclosed by *Pacific Lumber*.

First, Highland Capital contends the entire appeal is equitably moot because Appellants, with only a minor economic stake and questionable good faith, "seek[] nothing less than a complete unravelling of the confirmed Plan." It claims the court cannot "surgically excise[]" certain provisions, as the Funds request, because the Bankruptcy Code prohibits "modifications to confirmed plans after substantial consummation." *See* 11 U.S.C. § 1127(b). Not so.

"Although the Bankruptcy Code . . . restricts post-confirmation plan modifications, it does not expressly limit appellate review of plan confirmation orders." *Pacific Lumber*, 584 F.3d at 240 (footnote omitted) (citing 11 U.S.C. § 1127). This court may fashion "fractional relief" to

minimize an appellate disturbance's effect on the rights of third parties. *In re Tex. Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324, 328 (5th Cir. 2013) (denying dismissal on equitable mootness grounds because the court "could grant partial relief . . . without disturbing the reorganization"); *cf. In re Cont'l Airlines*, 91 F.3d 553, 571–72 (3d Cir. 1996) (en banc) (Alito, J., dissenting) (observing "a remedy could be fashioned in the present case to ensure that the [debtor's] reorganization is not undermined"). In short, Highland Capital's speculations are farfetched, as the court may fashion the remedy it sees fit without upsetting the reorganization.

Second, Appellants contend that equitable mootness cannot apply—full-stop—because this appeal concerns a liquidation plan, not a reorganization plan. We reject that premise. *See infra* Part IV.A. Even if it were correct, however, this court has conducted the equitable-mootness inquiry for a Chapter 11 liquidation plan in the past. *See In re Superior Offshore Int'l, Inc.*, 591 F.3d 350, 353–54 (5th Cir. 2009). And other circuits have squarely rejected the categorical bar proposed by Appellants. *See In re Abengoa Bioenergy Biomass of Kan., LLC*, 958 F.3d 949, 956–57 (10th Cir. 2020); *In re BGI, Inc.*, 772 F.3d 102, 107–09 (2d Cir. 2014). We do the same.

Finally, Appellants assert that because Highland Capital and NexPoint Advisors, L.P. jointly moved to certify the appeal, it should be estopped from arguing the appeal is equitably moot. They cite no legal support for that approach. We decline to adopt it.

Instead, we proceed with a claim-by-claim analysis, as our precedent requires. Highland Capital suggests only two claims are equitably moot: (1) the protection-provisions challenge and (2) the absolute-priority-rule challenge. Neither provides a basis for equitable mootness.

For the protection provisions, Highland Capital anticipates that, without the provisions, its officers, employees, trustees, and Oversight Board

members would all resign rather than be exposed to Dondero-initiated litigation. Those resignations would disrupt the Reorganized Debtor's operation, "significant[ly] deteriorat[ing] asset values due to uncertainty." Appellants disagree, offering several instances when this court has reviewed release, exculpation, and injunction provisions over calls for equitable mootness. *See, e.g.*, *In re Hilal*, 534 F.3d at 501; *Pacific Lumber*, 584 F.3d at 252; *In re Thru Inc.*, 782 F. App'x 339, 341 (5th Cir. 2019) (per curiam). In response, Highland Capital distinguishes this case because the provisions are "integral to the consummated plans." *See In re Charter Commc'ns, Inc.*, 691 F.3d 476, 486 (2d Cir. 2012). We again reject that premise. *See infra* Part IV.E.1. In any event, Appellants have the better argument.

We have before explained that "equity strongly supports appellate review of issues consequential to the integrity and transparency of the Chapter 11 process." *In re Hilal*, 534 F.3d 498, 500 (5th Cir. 2008). That is so because "the goal of finality sought in equitable mootness analysis does not outweigh a court's duty to protect the integrity of the process." *Pacific Lumber*, 584 F.3d at 252. As in *Pacific Lumber*, the legality of a reorganization plan's non-consensual non-debtor release is consequential to the Chapter 11 process and so should not escape appellate review in the name of equity. *Ibid.* The same is true here. Equitable mootness does not bar our review of the protection provisions.

For the absolute-priority-rule challenge,[10] Highland Capital contends our review requires us to "rejigger class recoveries." *Pacific Lumber* is again instructive. There, the court declined to apply equitable mootness to a secured creditor's absolute-priority-rule challenge, as no other panel had

[10] While the issue is nearly forfeited for inadequate briefing, it fails on the merits regardless. *See Roy v. City of Monroe*, 950 F.3d 245, 251 (5th Cir. 2020).

extended the doctrine so far. *Id.* at 243. Similarly, Highland Capital fails to identify a single case in which this court has declined review of the treatment of a class of creditor's claims resulting from a cramdown. *See id.* at 252. Regardless, Appellants challenge the distributions to classes 8, 10, and 11. According to Highland Capital's own declaration, "Class 8 General Unsecured Claims have received their Claimant Trust Interests." But there is no evidence that classes 10 or 11 have received any distributions. *Contra Pacific Lumber*, 584 F.3d at 251 (holding certain claims equitably moot where "the smaller unsecured creditors" had already "received payment for their claims"). As a result, the relief requested would not affect third parties or the success of the Plan. *See In re Manges*, 29 F.3d at 1039. The doctrine of equitable mootness does not bar our review of the cramdown and treatment of class-8 creditors.

We DENY Highland Capital's motion to dismiss the appeal as equitably moot.

IV. Discussion

As to the merits, Appellants fire a bankruptcy-law blunderbuss. They contest the Plan's classification as a reorganization plan, the Plan's satisfaction of the absolute priority rule, the Plan's confirmation despite Highland Capital's noncompliance with Bankruptcy Rule 2015.3, and the sufficiency of the evidence supporting the court's factual finding that the Funds are "owned/controlled" by Dondero. For each, we disagree and affirm. We do, however, agree with Appellants that the bankruptcy court exceeded its statutory authority under § 524(e) by exculpating certain non-debtors, and so we reverse and vacate the Plan only to that extent.

A. Discharge of Debt

We begin with the Plan's classification as a reorganization plan, allowing for automatic discharge of the debts. The confirmation of a Chapter

11 restructuring plan "discharges the debtor from any [pre-confirmation] debt" unless, under the plan, the debtor liquidates its assets, stops "engag[ing] in [its] business after consummation of the plan," and would be denied discharge in a Chapter 7 case. 11 U.S.C. § 1141(d)(1), (3); *see In re Sullivan*, No. 99-11107, 2000 WL 1597984, at *2 (5th Cir. Sept. 26, 2000) (per curiam). The bankruptcy court concluded Highland Capital continued to engage in business after plan consummation, so its debts are automatically discharged. The Trusts call foul because, in their view, Highland Capital's "wind down" of its portfolio management is not a continuation of its business. We disagree.

Whether a corporate debtor "engages in business" is "relatively straightforward." *Um v. Spokane Rock I, LLC*, 904 F.3d 815, 819 (9th Cir. 2018) (contrasting the more complex question for individual debtors); *see Grausz v. Sampson (In re Grausz)*, 63 F. App'x 647, 650 (4th Cir. 2003) (per curiam) (same). That is, "a business entity will not engage in business post-bankruptcy when its assets are liquidated and the entity is dissolved." *Um*, 904 F.3d at 819 (collecting cases).[11] But even a temporary continuation of business after a plan's confirmation is sufficient to discharge a Chapter 11 debtor's debt. *See In re T-H New Orleans Ltd. P'ship*, 116 F.3d 790, 804 n.15 (5th Cir. 1997) (recognizing a debtor's "conducting business for two years following Plan confirmation satisfies § 1141(d)(3)(B)" (citation omitted)). That is the case here.

[11] *See, e.g.*, *In re W. Asbestos Co.*, 313 B.R. 832, 853 (Bankr. N.D. Cal. 2003) (holding corporate debtor was not engaging in business by merely having directors and officers, rights under an insurance policy, and claims against it); *In re Wood Fam. Ints., Ltd.*, 135 B.R. 407, 410 (Bankr. D. Colo. 1989) (holding corporate debtor was not engaging in business when the plan called for liquidation and discontinuation of its business upon confirmation).

By the plain terms of the Plan, Highland Capital has and will continue its business as the Reorganized Debtor for several years. Indeed, much of this appeal concerns objections to Highland Capital's "continu[ing] to manage the assets of others." Because the Plan contemplates Highland Capital "engag[ing] in business after consummation," 11 U.S.C. § 1141(d)(1), the bankruptcy court correctly held Highland Capital was eligible for automatic discharge of its debts.[12]

B. Absolute Priority Rule

Next, we consider the Plan's compliance with the absolute-priority rule. When assessing whether a plan is "fair and equitable" in a cramdown scenario, courts must invoke the absolute-priority rule. 11 U.S.C. § 1129(b)(1); *see* 7 COLLIER ON BANKRUPTCY ¶ 1129.04. Under that rule, if a class of unsecured claimants rejects a plan, the plan must provide that those claimants be paid in full on the effective date *or* any junior interest "will not receive or retain under the plan . . . any property." 11 U.S.C. § 1129(b)(2)(B).[13]

Because class-8 claimants voted against the Plan, the bankruptcy court proceeded by nonconsensual confirmation. The court concluded the Plan was fair and equitable to class 8 and its distributions were in line with the absolute-priority rule. 11 U.S.C. § 1129(b)(2)(B). The Advisors claim the Plan violates the absolute priority rule by giving class-10 and -11 claimants a

[12] For the same reasons, we reject the Trusts' follow-on argument extending the same logic to the protection provisions.

[13] *See Pacific Lumber*, 584 F.3d at 244 (noting the rule "enforces a strict hierarchy of [creditor classes'] rights defined by state and federal law" to protect dissenting creditor classes); *see also In re Geneva Steel Co.*, 281 F.3d 1173, 1180 n.4 (10th Cir. 2002) ("[U]nsecured creditors stand ahead of investors in the receiving line and their claims must be satisfied before any investment loss is compensated." (citations omitted)).

"Contingent Claimant Trust Interest" without fully satisfying class-8 claimants. We agree the absolute-priority rule applies, and the Plan plainly satisfies it.

The Plan proposed to pay 71% of class-8 creditors' claims with *pro rata* distributions of interest generated by the Claimant Trust and then *pro rata* distributions from liquidated Claimant Trust assets. Classes 10 and 11 received a *pro rata* share of "Contingent Claimant Trust Interests," defined as a Claimant Trust Interest vesting only when the Claimant Trustee certifies that all class-8 claimants have been paid indefeasibly in full and all disputed claims in class 8 have been resolved. Voilà: no interest junior to class 8 will receive any property until class-8 claimants are paid.

But the Advisors point to Highland Capital's testimony and briefs to suggest the Contingent Claimant Trust Interests (received by classes 10 and 11) are property in some sense because they have value. That argument is specious. Of course, the Contingent Claimant Trust Interests have some small probability of vesting in the future and, thus, has some *de minimis* present value. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-08 (1988) (holding a junior creditor's receipt of a presently valueless equity interest is receipt of property). But the absolute-priority rule has never required us to bar junior creditors from ever receiving property. By the Plan's terms, no trust property vests with class-10 or -11 claimants "unless and until" class-8 claims "have been paid indefeasibly in full." *See* 11 U.S.C. § 1129(b)(2)(B)(ii). That plainly comports with the absolute-priority rule.

C. Bankruptcy Rule 2015.3

We turn to whether the failure to comply with Bankruptcy Rule of Procedure 2015.3 bars the Plan's confirmation. The Independent Directors failed to file periodic financial reports per Federal Rule of Bankruptcy Procedure 2015.3(a) about entities "in which the [Highland Capital] estate

holds a substantial or controlling interest." The Advisors claim the failure dooms the Plan's confirmation because the Plan proponent failed to comply "with the applicable provisions of this title." 11 U.S.C. § 1129(a)(2). We disagree.

Rule 2015.3 cannot be an applicable provision of Title 11 because the Federal Rules of Bankruptcy Procedure are not provisions of the Bankruptcy Code. *See Bonner v. Adams (In re Adams)*, 734 F.2d 1094, 1101 (5th Cir. 1984) ("The Bankruptcy Rules Enabling Act, 28 U.S.C. § 2075, provides that the Supreme Court may prescribe 'by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure' in bankruptcy courts."); *cf. In re Mandel*, No. 20-40026, 2021 WL 3642331, at *6 n.7 (5th Cir. Aug. 17, 2021) (per curiam) (noting "Rule 2015.3 implements section 419 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," which amended 28 U.S.C. § 2073). The Advisors' attempt to tether the rule to the bankruptcy trustee's general duties lacks any legal basis. *See* 11 U.S.C. §§ 704(a)(8), 1106(a)(1), 1107(a). The bankruptcy court, therefore, correctly overruled the Advisors' objection.

D. Factual Findings

One factual finding is in dispute, but we see no clear error. The bankruptcy court found that, despite their purported independence, the Funds are entities "owned and/or controlled by [Dondero]." The Funds ask the court to vacate the factual finding because it threatens the Funds' compliance with federal law and damages their reputations and values. According to the Funds, the characterization is unfair, as *they* are not litigious like Dondero and are completely independent from him. Highland Capital maintains Dondero has sole discretion over the Funds as their portfolio manager and through his control of the Advisors, so the finding is supported by the record.

"Clear error is a formidable standard: this court disturbs factual findings only if left with a firm and definite conviction that the bankruptcy court made a mistake." *In re Krueger*, 812 F.3d 365, 374 (5th Cir. 2016) (cleaned up). We defer to the bankruptcy court's credibility determinations. *See Randall & Blake, Inc. v. Evans (In re Canion)*, 196 F.3d 579, 587–88 (5th Cir. 1999).

Here, the bankruptcy court drew its factual finding from the testimony of Jason Post, the Advisors' chief compliance officer, and Dustin Norris, an executive vice president for the Funds and the Advisors. Post testified that the Funds have independent board members that run them. But the bankruptcy court found Post not credible because "he abruptly resigned" from Highland Capital at the same time as Dondero and is currently employed by Dondero. Norris testified that Dondero "owned and/or controlled" the Funds and Advisors. The bankruptcy court found Norris credible and relied on his testimony. The bankruptcy court also observed that none of the Funds' board members testified in the bankruptcy case and all "engaged with the Highland complex for many years." Because nothing in this record leaves us with a firm and definite conviction that the bankruptcy court made a mistake in finding that the Funds are "owned and/or controlled by [Dondero]," we leave the bankruptcy court's factual finding undisturbed.

E. The Protection Provisions

Finally, we address the legality of the Plan's protection provisions. As discussed, the Plan exculpates certain non-debtor third parties supporting the Plan from post-petition lawsuits not arising from gross negligence, bad faith, or willful or criminal misconduct. It also enjoins certain parties "from taking any actions to interfere with the implementation or consummation of the Plan." The injunction requires that, before any lawsuit is filed, the plaintiff must seek the bankruptcy court's approval of the claim as

"colorable"—*i.e.*, the bankruptcy court acts as a gatekeeper. Together, the provisions screen and prevent bad-faith litigation against Highland Capital, its successors, and other bankruptcy participants that could disrupt the Plan's effectiveness.

The bankruptcy court deemed the provisions legal, necessary under the circumstances, and in the best interest of all parties. We agree, but only in part. Though the injunction and gatekeeping provisions are sound, the exculpation of certain non-debtors exceeds the bankruptcy court's authority. We reverse and vacate that limited portion of the Plan.

1. *Non-Debtor Exculpation*

We start with the scope of the non-debtor exculpation. In a Chapter 11 bankruptcy proceeding, "discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." 11 U.S.C. § 524(e). Contrary to the bankruptcy court's holding, the exculpation here partly runs afoul of that statutory bar on non-debtor discharge by reaching beyond Highland Capital, the Committee, and the Independent Directors. *See Pacific Lumber*, 584 F.3d 251–53. We must reverse and strike the few unlawful parts of the Plan's exculpation provision.

The parties agree that *Pacific Lumber* controls and also that the bankruptcy court had the power to exculpate both Highland Capital and the Committee members. Appellants, however, submit the bankruptcy court improperly stretched *Pacific Lumber* to shield other non-debtors from breach-of-contract and negligence claims, in violation of § 524(e). Highland Capital counters that the exculpation provision is a commonplace Chapter 11 term, is appropriate given Dondero's litigious nature, does not implicate § 524(e), and merely provides a heightened standard of care.

To support that argument, Highland Capital highlights the distinction between a concededly unlawful release of all non-debtor liability and the

Plain's limited exculpation of non-debtor post-petition liability. *See, e.g.*, *In re PWS Holding Corp.*, 228 F.3d 224, 246–47 (3d Cir. 2000) (describing releases as "eliminating" a covered party's liability "altogether" while exculpation provisions "set[] forth the applicable standard of liability" in future litigation). According to Highland Capital, the Third and Ninth Circuits have adopted that distinction when applying § 524(e). *See Blixseth v. Credit Suisse*, 961 F.3d 1074, 1084 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021); *In re PWS Holding*, 228 F.3d at 246–47. Under those cases, narrow exculpations of post-petition liability for certain critical third-party non-debtors are lawful "appropriate" or "necessary" actions for the bankruptcy court to carry out the proceeding through its statutory authority under § 1123(b)(6) and § 105(a). *See* 11 U.S.C. § 1123(b)(6) ("[A] plan may . . . include any other appropriate provision not inconsistent with the applicable provisions of this title."); *id* § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.").

Highland Capital reads *Pacific Lumber* as "in step with the law in [those] other circuits" by allowing a limited exculpation of post-petition liability. *Cf. Blixseth*, 961 F.3d at 1084. We disagree. As the Ninth Circuit acknowledged, our court in *Pacific Lumber* arrived at "a conclusion opposite [the Ninth Circuit's]." 961 F.3d at 1085 n.7. Moreover, the Ninth Circuit expressly disavowed *Pacific Lumber*'s rationale—that an exculpation provision provides a "fresh start" to a non-debtor in violation of § 524(e)—because, in the Ninth Circuit's view, the post-petition exculpation "affects only claims arising from the bankruptcy proceedings themselves." *Ibid.* We are not persuaded, as Highland Capital contends, that the Ninth Circuit was "sloppy" and simply "misread *Pacific Lumber*." *See* O.A. Rec. 19:45–21:38.

The simple fact of the matter is that there is a circuit split concerning the effect and reach of § 524(e).[14] Our court along with the Tenth Circuit hold § 524(e) categorically bars third-party exculpations absent express authority in another provision of the Bankruptcy Code. *Pacific Lumber*, 584 F.3d at 252–53; *Landsing Diversified Props. v. First Nat'l Bank & Tr. Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990) (per curiam). By contrast, the Ninth Circuit joins the Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits in reading § 524(e) to allow varying degrees of limited third-party exculpations. *Blixseth*, 961 F.3d at 1084; *accord In re PWS Holding*, 228 F.3d at 246–47 (allowing third-party releases for "fairness, necessity to the reorganization, and specific factual findings to support these conclusions"); *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 143 (2d Cir. 2005); *In re A.H. Robins Co.*, 880 F.2d 694, 702 (4th Cir. 1989); *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002); *In re Airadigm Commc'ns., Inc.*, 519 F.3d 640, 657 (7th Cir. 2008); *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015).

Our *Pacific Lumber* decision was not blind to the countervailing view, as it twice cites the Third Circuit's contrary holding in other contexts. *See* 584 F.3d at 241, 253 (citing *In re PWS Holding*, 228 F.3d at 236–37, 246). But we rejected the parsing between limited exculpations and full releases that Highland Capital now requests. We are obviously bound to apply our own precedent. *See Hidalgo Cnty. Emergency Serv. Found. v. Carranza (In re Hidalgo Cnty. Emergency Serv. Found.)*, 962 F.3d 838, 841 (5th Cir. 2020)

[14] Amicus's contention that failing to adopt the Ninth Circuit's holding "would generate a clear circuit split" is wrong. There already is one. *See* Petition for Writ of Certiorari, *Blixseth v. Credit Suisse*, 141 S. Ct. 1394 (No. 20-1028) (highlighting the circuits' divergent approaches to the non-debtor discharge bar under § 524(e)).

("Under our well-recognized rule of orderliness, . . . a panel of this court is bound by circuit precedent." (citation omitted)).

Under *Pacific Lumber*, § 524(e) does not permit "absolv[ing] the [non-debtor] from any negligent conduct that occurred during the course of the bankruptcy" absent another source of authority. 584 F.3d at 252–53; *see also In re Zale Corp.*, 62 F.3d 746, 760 (5th Cir. 1995). At oral argument, Highland Capital pointed only to § 1123(b)(6) and § 105(a) as footholds. *See* O.A. Rec. 16:45–17:28. But in this circuit, § 105(a) provides no statutory basis for a non-debtor exculpation. *In re Zale*, 62 F.3d at 760 (noting "[a] § 105 injunction cannot alter another provision of the code" (citing *In re Oxford Mgmt., Inc.*, 4 F.3d 1329, 1334 (5th Cir. 1993))). And the same logic extends to § 1123(b)(6), which allows a plan to "include any other appropriate provision *not inconsistent with the applicable provisions of this title*." 11 U.S.C. § 1123(b)(6) (emphasis added).

Pacific Lumber identified two sources of authority to exculpate non-debtors. *See* 584 F.3d at 252–53. The first is to channel asbestos claims (not present here). *Id.* at 252 (citing 11 U.S.C. § 524(g)). The second is to provide a limited qualified immunity to creditors' committee members for actions within the scope of their statutory duties. *Pacific Lumber*, 584 F.3d at 253 (citing 11 U.S.C. § 1103(c)); *see In re Vitro S.A.B. de CV*, 701 F.3d 1031, 1069 (5th Cir. 2012). And, though not before the court in *Pacific Lumber*, we have also recognized a limited qualified immunity to bankruptcy trustees unless they act with gross negligence. *In re Hilal*, 534 F.3d at 501 (citing *In re Smyth*, 207 F.3d 758, 762 (5th Cir. 2000)); *accord Baron v. Sherman (In re Ondova Ltd.)*, 914 F.3d 990, 993 (5th Cir. 2019) (per curiam). If other sources exist, Highland Capital failed to identify them. So we see no statutory authority for the full extent of the exculpation here.

The bankruptcy court read *Pacific Lumber* differently. In its view, *Pacific Lumber* created an additional ground to exculpate non-debtors: when the record demonstrates that "costs [a party] might incur defending against suits alleging such negligence are likely to swamp either [it] or the consummated reorganization." 584 F.3d at 252. We do not read the decision that way. The bankruptcy court's underlying factual findings do not alter whether it has statutory authority to exculpate a non-debtor. That is the holding of *Pacific Lumber*.

That leaves one remaining question: whether the bankruptcy court can exculpate the Independent Directors under *Pacific Lumber*. We answer in the affirmative. As the bankruptcy court's governance order clarified, nontraditional as it may be, the Independent Directors were appointed to act together as the bankruptcy trustee for Highland Capital. Like a debtor-in-possession, the Independent Directors are entitled to all the rights and powers of a trustee. *See* 11 U.S.C. § 1107(a); 7 COLLIER ON BANKRUPTCY ¶ 1101.01. It follows that the Independent Directors are entitled to the limited qualified immunity for any actions short of gross negligence. *See In re Hilal*, 534 F.3d at 501. Under this unique governance structure, the bankruptcy court legally exculpated the Independent Directors.

In sum, our precedent and § 524(e) require any exculpation in a Chapter 11 reorganization plan be limited to the debtor, the creditors' committee and its members for conduct within the scope of their duties, 11 U.S.C. § 1103(c), and the trustees within the scope of their duties, *see Baron*, 914 F.3d at 993. And so, excepting the Independent Directors and the Committee members, the exculpation of non-debtors here was unlawful.

Accordingly, the other non-debtor exculpations must be struck from the Plan. *See Pacific Lumber*, 584 F.3d at 253.[15]

As it stands, the Plan's exculpation provision extends to Highland Capital and its employees and CEO; Strand; the Reorganized Debtor and HCMLP GP LLC; the Independent Directors; the Committee and its members; the Claimant Trust, its trustee, and the members of its Oversight Board; the Litigation Sub-Trust and its trustee; professionals retained by the Highland Capital and the Committee in this case; and all "Related Persons." Consistent with § 524(e), we strike all exculpated parties from the Plan except Highland Capital, the Committee and its members, and the Independent Directors.

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[15] Highland Capital, like the bankruptcy court, claims the *res judicata* effect of the January and July 2020 orders appointing the independent directors and appointing Seery as CEO binds the court to include the protection provisions here. We lack jurisdiction to consider collateral attacks on final bankruptcy orders even when it concerns whether the court properly exercised jurisdiction or authority at the time. *See Travelers Indem. Co. v. Bailey*, 557 U.S. 137 (2009); *In re Linn Energy, L.L.C.*, 927 F.3d 862, 866–67 (5th Cir. 2019) (quoting *Bailey*, 557 U.S. at 152). To the extent Appellants seek to roll back the protections in the bankruptcy court's January 2020 and July 2020 orders (which is not clear from their briefing), such a collateral attack is precluded.

As a result, the bankruptcy court was correct insofar as *those* orders have the effect of exculpating the Independent Directors and Seery in his executive capacities, but it was incorrect that *res judicata* mandates their inclusion in the Plan's new exculpation provision. Despite removal from the exculpation provision in the confirmation order, the Independent Directors' agents, advisors, and employees, as well as Seery in his official capacities are all exculpated to the extent provided in the January and July 2020 orders, given the orders' ongoing *res judicata* effects and our lack of jurisdiction to review those orders. But that says nothing of the effect of the Plan's exculpation provision.

2. *Injunction & Gatekeeper Provisions*

We now turn to the Plan's injunction and gatekeeper provisions. Appellants object to the bankruptcy court's injunction as vague and the gatekeeper provision as overbroad. We are unpersuaded.

First, Appellants' primary contention—that the Plan's injunction "is broad" by releasing non-debtors in violation of § 524(e)—is resolved by our striking the impermissibly exculpated parties. *See supra* Part IV.E.1.

Second, Appellants dispute the permanency of the injunction for the legally exculpated parties by enjoining conduct "on and after the Effective Date." Even assuming the issue was preserved,[16] permanency alone is no reason to alter a bankruptcy court's otherwise-lawful injunction on appeal. *See In re Zale*, 62 F.3d at 759–60 (recognizing the bankruptcy court's jurisdiction to issue an injunction in the first place allowed it to issue a permanent injunction).

Third, the Advisors argue that the injunction is "overbroad and vague" because it does not define what it means to "interfere" with the "implementation or consummation of the Plan." That is unsupported by the record. As the bankruptcy court recognized, the Plan defined what constitutes interference: (i) filing a lawsuit, (ii) enforcing judgments, (iii) enforcing security interests, (iv) asserting setoff rights, or (v) acting "in any manner" not conforming with the Plan. The injunction is not unlawfully overbroad or vague.

Finally, Appellants maintain that the gatekeeper provision impermissibly extends to unrelated claims over which the bankruptcy court

[16] *See Roy*, 950 F.3d at 251 ("Failure adequately to brief an issue on appeal constitutes waiver of that argument." (citation omitted)).

lacks subject-matter jurisdiction. *See In re Craig's Stores of Tex., Inc.*, 266 F.3d 388, 390 (5th Cir. 2001) (noting a bankruptcy court retains jurisdiction post-confirmation only over "matters pertaining to the implementation or execution of the plan" (citations omitted)). While that may be the case, our precedent requires we leave that determination to the bankruptcy court in the first instance.

Courts have long recognized bankruptcy courts can perform a gatekeeping function. Under the "*Barton* doctrine," the bankruptcy court may require a party to "obtain leave of the bankruptcy court before initiating an action in district court when the action is against the trustee or other bankruptcy-court-appointed officer, for acts done in the actor's official capacity." *Villegas v. Schmidt*, 788 F.3d 156, 159 (5th Cir. 2015) (emphasis added) (quoting *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000)); *accord Barton v. Barbour*, 104 U.S. 126 (1881).[17] In *Villegas*, we held "that a party must continue to file with the relevant bankruptcy court for permission to proceed with a claim against the trustee." 788 F.3d at 158. Relevant here, we left to the bankruptcy court, faced with pre-approval of a claim, to determine whether it had subject matter jurisdiction over that claim in the first instance. *Id.* at 158–59; *see, e.g.*, *Carroll v. Abide*, 788 F.3d 502, 506–07 (5th Cir. 2015) (noting *Villegas* "rejected an argument that the *Barton* doctrine does not apply when the bankruptcy court lacked jurisdiction"). In other words, we need not evaluate whether the bankruptcy court would have

[17] The Advisors also maintain that Highland Capital is neither a receiver nor a trustee, so *Barton* has no application here. We disagree. Highland Capital, for all practical purposes, was a debtor in possession entitled to the rights of a trustee. *See* 7 COLLIER ON BANKRUPTCY ¶ 1101.01 ("The debtor in possession is generally vested with all of the rights and powers of a trustee as set forth in section 1106 . . . ."); *see also Carter*, 220 F.3d at 1252 n.4. (finding no distinction between bankruptcy court "approved" and bankruptcy court "appointed" officers).

jurisdiction under every conceivable claim falling under the widest interpretation of the gatekeeper provision. We leave that to the bankruptcy court in the first instance.[18]

* * *

In sum, the Plan violates § 524(e) but only insofar as it exculpates and enjoins certain non-debtors. The exculpatory order is therefore vacated as to all parties *except* Highland Capital, the Committee and its members, and the Independent Directors for conduct within the scope of their duties. We otherwise affirm the inclusion of the injunction and the gatekeeper provisions in the Plan.[19]

V. Conclusion

Highland Capital's motion to dismiss the appeal as equitably moot is DENIED. The bankruptcy court's judgment is AFFIRMED in part, REVERSED in part, and REMANDED for further proceedings consistent with this opinion.

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[18] For the same reasons, we also leave the applicability of *Barton*'s limited statutory exception to the bankruptcy and district courts in the first instance. *See* 28 U.S.C. § 959(a) (allowing suit, without leave of the appointing court, if the challenged acts relate to the trustee or debtor in possession "carrying on business connected with [their] property").

[19] Nothing in this opinion should be construed to hinder the bankruptcy court's power to enjoin and impose sanctions on Dondero and other entities by following the procedures to designate them vexatious litigants. *See In re Carroll*, 850 F.3d 811, 815 (5th Cir. 2017) (per curiam). But non-debtor exculpation within a reorganization plan is not a lawful means to impose vexatious litigant injunctions and sanctions.

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Highland Ch. 11 Remand Reinforces Gatekeeping Availability

By **Evan Hollander, Daniel Rubens and David Litterine-Kaufman** (March 10, 2023, 4:50 PM EST)

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In an Aug. 31, 2022, **article**, we described a notable decision by the U.S. Court of Appeals for the Fifth Circuit concerning the bankruptcy of Highland Capital Management LP, which limited the permissible scope of plan provisions that shield third parties from liability for alleged misconduct during the bankruptcy proceedings.[1]

Now, the U.S. Bankruptcy Court for the Northern District of Texas has weighed in on remand, limiting the exculpation provisions of the plan as directed by the Fifth Circuit and reinforcing the broad scope of the plan's original gatekeeping provisions.

Background

As we previously described, the Fifth Circuit's 2022 **decision** partially affirmed the bankruptcy court's order confirming Highland's Chapter 11 plan of reorganization, reversing only the limited portion of the plan that exculpated several nondebtor parties from claims relating to their roles in the bankruptcy proceedings.[2]

Such exculpation provisions — common to Chapter 11 plans — protect the exculpated parties from legal claims related to their involvement in the proceedings, except to the extent those claims allege bad faith, fraud, gross negligence or similar misconduct.

The Fifth Circuit's decision highlighted a split of authority among the federal courts of appeals about bankruptcy courts' authority under Title 11 of the U.S. Code, Section 524(e), to approve plans exculpating third parties.

The exculpation provision, however, was not the only plan provision that purported to protect third parties. The plan also included a gatekeeping provision and an injunction provision.

The gatekeeping provision required that, before claimants could proceed with claims asserted against nondebtor protected parties arising from the bankruptcy proceedings, such claimants must seek a determination from the bankruptcy court that those claims are colorable.

The gatekeeping provision further authorized the bankruptcy court, to the extent legally permissible, to adjudicate those claims, if found colorable. The injunction provision prohibited conduct "in violation[] of the discharge or otherwise inconsistent with the Plan."[3]

The Fifth Circuit's decision narrowed the bankruptcy court's exculpatory authority, but it did not disturb these latter two provisions, potentially leaving gatekeeping as an alternative, albeit weaker, protection for bankruptcy participants in the absence of broad exculpation authority.

However, the Fifth Circuit's opinion raised some uncertainty regarding the availability of gatekeeping

and injunction protections for nonexculpated third parties.

In response to a petition for rehearing, the Fifth Circuit struck a sentence from the opinion that originally described the gatekeeping and injunction provisions as perfectly lawful, in contrast to the exculpation provision.[4]

Notwithstanding the Fifth Circuit's remand to the bankruptcy court, two petitions for certiorari to review the Fifth Circuit's decision are pending in the U.S. Supreme Court.[5]

Both ask the court to weigh in on the scope of a bankruptcy court's power to confirm a plan with third-party exculpation provisions in light of Section 524(e). A decision on those petitions is likely this spring.

Discussion

On remand to the bankruptcy court, the parties proceeded to litigate the vitality of the Highland Capital plan's gatekeeping and injunction provisions in the face of the Fifth Circuit's holding on exculpation.

Several funds associated with the debtor's co-founder and former CEO James Dondero argued that the Fifth Circuit's narrowing of the exculpation provisions should apply to those other provisions, too — i.e., that the same nondebtor parties excluded from the exculpation provisions by the Fifth Circuit should also be excluded from the gatekeeping and injunction provisions.

The bankruptcy court disagreed, affirming the continuing, independent protections for third parties by such provisions. The bankruptcy court maintains the scope of the gatekeeping and injunction provisions.

In an opinion issued on Feb. 27, the bankruptcy court rejected the arguments advanced by the funds associated with Dondero that the gatekeeping and injunction provisions must be narrowed in tandem with the exculpation provision.[6] The court relied on several key considerations:

- The three relevant provisions "all had distinct functions; they were not in any way redundant";[7]
- The list of parties protected by the gatekeeping provision was "not identical" to the list of parties exculpated by the exculpation provision even prior to the Fifth Circuit's restriction of the exculpation provisions of the plan;[8]
- Nothing in the Fifth Circuit's opinion purported to disturb the gatekeeping and injunction provisions — those provisions, the court of appeals explained, "are sound."[9]

In granting the debtor's motion to conform the plan to the Fifth Circuit's decision — and rejecting the proposed narrowing of the gatekeeper and injunction provisions — the bankruptcy court highlighted numerous statements in the Fifth Circuit's opinion indicating that those provisions remained unaffected.

The bankruptcy court also explained that the gatekeeping provision "is mostly a tool to deal with any future, potential lawsuits," but narrowing it in the proposed manner "would mean that the Gatekeeper Provision would have no effect on any conduct that occurs after the Plan Effective Date."[10]

Appellate Practitioners Beware: Rehearing May Not Mean Relief

The bankruptcy court's opinion was a particularly interesting exercise in interpreting appellate decisions — or perhaps acknowledging the inherent limitations on interpreting them.

It also demonstrates that requests for panel hearing aimed at clarification, even if granted, may not always yield meaningful relief, and could instead further entrench the holding the movant seeks to

avoid.

Here, the Fifth Circuit's opinion originally described the gatekeeping and injunction provisions as "perfectly lawful," in contrast to the exculpation provision.[11] After commentators raised questions about the decision's effect on the gatekeeping and injunction provisions, the appellants sought rehearing, hoping to cast doubt on those provisions' status.

The Fifth Circuit panel promptly granted that request and struck the "perfectly lawful" language, without further comment.[12]

But on remand, the bankruptcy court concluded that that change had no relevant legal effect, and the gatekeeping and injunction provisions remain, indeed, perfectly lawful.[13]

As the bankruptcy court conceded, it was "awkward ... to attempt to be a mind-reader regarding editorial or wordsmithing decisions undertaken by the Fifth Circuit," but it did not "know how it could be clearer" that the scope of the gatekeeping and injunction provisions survived the appeal wholly intact.[14]

Therefore, what might have initially seemed like a rehearing success story turned out to be illusory.

Conclusion

As we previously predicted, the Fifth Circuit's Highland Capital decision has increased the importance of tools like gatekeeping in lieu of exculpation.

The bankruptcy court's recent decision confirms the viability of gatekeeping provisions and their broad potential scope even in those circuits that have limited the availability of exculpation for third parties.

Meanwhile, a two-tiered system remains in the Fifth Circuit.

Parties entitled to the benefits of exculpation may be shielded from suits over merely negligent conduct in connection with their participation in a bankruptcy case, while parties not entitled to exculpation may receive a lesser degree of protection — i.e., review for a determination whether any colorable claim has been asserted against such parties resulting from their participation in the case.

That gatekeeping function has at least two potential protective values.

First, it channels claims related to conduct in respect of bankruptcy proceedings to the bankruptcy court for adjudication. This channeling could lead to more efficient motion practice on the viability of the asserted claims because the bankruptcy court likely would already be familiar with the background of the case.

Second, it will remain for the bankruptcy courts to determine how much scrutiny to apply under the colorable claim standard, which goes undefined in the Highland Capital plan.

In the context of derivative standing, courts have construed "colorable" to mirror the plausibility standard applied under Federal Rule of Civil Procedure 12(b)(6)[15] — although some courts will undertake a limited evidentiary review for proper factual support.[16]

If courts equate colorable with the Rule 12(b)(6) plausibility standard, gatekeeping provisions would not provide any substantive protection against such claims not already available under the Federal Rules of Civil Procedure, or state law analogs, and the main benefit to those defending against such claims would be the presumed efficiencies from channeling to the bankruptcy court referenced above.

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[1] In re Highland Cap. Mgmt., L.P. (Highland II), 48 F.4th 419 (5th Cir. 2022).

[2] Id. at 435.

[3] In re Highland Cap. Mgmt., L.P. (Highland III), No. 19-34054, 2023 WL 2250145, at *5 (Bankr. N.D. Tex. Feb. 27, 2023).

[4] In re Highland Cap. Mgmt., L.P. (Highland I), No. 21-10449, 2022 WL 3571094, at *13 (5th Cir. Aug. 19, 2022) (vacated on rehearing by Highland II).

[5] Highland Cap. Mgmt., L.P. v. NexPoint Advisors, L.P., No. 22-631 (U.S. docketed Jan. 5, 2023); NexPoint Advisors, L.P. v. Highland Cap. Mgmt., L.P., No. 22-669 (U.S. docketed Jan. 16, 2023).

[6] Highland III, 2023 WL 2250145.

[7] Id. at *3.

[8] Id. at *6.

[9] Highland II, 48 F.4th at 435.

[10] Highland III, 2023 WL 2250145, at *9.

[11] Highland I, 2022 WL 3571094, at *13.

[12] Highland II, 48 F.4th at 424.

[13] Highland III, 2023 WL 2250145, at *9.

[14] Id.

[15] E.g., NetJets Sales, Inc. v. RS Air, LLC (In re RS Air, LLC), No. NC-21-1102-GTB, 2022 WL 1284012, at *4 (B.A.P. 9th Cir. Apr. 26, 2022); In re On-Site Fuel Serv., Inc., No. 18-04196-NPO, 2020 WL 3707004, at *12 (Bankr. S.D. Miss. May 8, 2020).

[16] In re Sabine Oil & Gas Corp., 562 B.R. 211, 222 (S.D.N.Y. 2016).

5th Circ. Ruling Highlights Split On Ch. 11 Exculpation

By **Evan Hollander, Daniel Rubens and David Litterine-Kaufman** (August 31, 2022)

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In the latest development in the extensive litigation arising from the bankruptcy of Highland Capital Management LP, the U.S. Court of Appeals for the Fifth Circuit recently imposed strict limitations on bankruptcy courts' statutory authority to exculpate third parties from claims relating to their roles in the bankruptcy proceedings.[1]

The court's precedential opinion, authored by U.S. Circuit Judge Stuart Kyle Duncan, expressly notes a split of authority among the federal courts of appeals as to the meaning of Title 11 of the U.S. Code, Section 524(e), leaving an uncertain landscape for parties that wish to include exculpatory provisions or nonconsensual releases in Chapter 11 plans.

Background

The Highland Capital restructuring has been particularly litigious, and one co-founder's, James Dondero, litigation conduct led the U.S. Bankruptcy Court for the Northern District of Texas to conclude it was appropriate to exculpate a broad range of actors from suits arising from their involvement in the bankruptcy. Exculpation provisions are common features of Chapter 11 plans.

They generally protect exculpated parties from legal claims related to their involvement in the bankruptcy proceedings, except to the extent those claims allege bad faith, fraud, gross negligence, or similar misconduct.[2]

The plan confirmed by the bankruptcy court in Highland Capital included an exculpation provision that applied to nearly all bankruptcy participants, including the debtor, its officers and employees, a general partner of the debtor, the creditors' committee and its members, the successor entities under the plan, an oversight board comprised of four creditors and a restructuring advisor, and a catchall class of all parties related to any of the enumerated exculpated parties.[3]

The provision also covered three independent directors whom the creditors' committee had selected and, with the bankruptcy court's approval, authorized to exercise the powers of a bankruptcy trustee on behalf of the debtor.[4]

The confirmed plan also included a so-called gatekeeping provision, requiring that bankruptcy participants bring all claims against the exculpated parties first to the bankruptcy court to determine whether they are colorable and can proceed.[5]

Several creditors, including Dondero, objected to the plan's exculpatory and gatekeeping provisions. The bankruptcy court overruled those objections and confirmed the plan.

The objectors then obtained permission to appeal directly to the Fifth Circuit to challenge these provisions and other aspects of the confirmed plan.

The Fifth Circuit's Decision

After concluding that the appeal was not equitably moot, the Fifth Circuit affirmed in part and reversed in part the bankruptcy court's order confirming the plan, holding that the bankruptcy court lacked the authority to exculpate several of the nondebtor parties covered by the plan's exculpation provision.

In so concluding, the Fifth Circuit looked to Section 524, which governs the effect of discharge. Subsection (e) states that, except as otherwise provided, "discharge of a debt … does not affect the liability of any other entity on, or the property of any other entity for, such debt."

Relying on existing circuit precedent interpreting Section 524(e), the Fifth Circuit concluded that this provision "categorically bars third-party exculpations absent express authority in another provision of the Bankruptcy Code."[6]

The Fifth Circuit concluded that in light of Section 524(e)'s bar and the lack of support elsewhere in the code, the exculpation provision was unlawful as it applied to certain of the nondebtor parties covered by the plan provision.

Surveying the rest of the code, the Fifth Circuit found no alternative statutory basis for providing exculpation under a plan to parties other than the debtor, the creditors' committee and its members, and the Chapter 11 trustee.

While the debtor had suggested that such alternative basis could be found in Title 11 of the U.S. Code, Section 105[7] and 1123(b)(6),[8] the Fifth Circuit concluded that neither provision provided a statutory basis for extending nondebtor exculpation.[9]

Based on a review of circuit precedent, the Fifth Circuit recognized only three potential sources of statutory authority:

1. "A limited qualified immunity to creditors' committee members for actions within the scope of their statutory duties";

2. "A limited qualified immunity to bankruptcy trustees unless they act with gross negligence"; and

3. The authority under Section 524(g) to channel asbestos-related claims, not relevant to the Highland Capital plan.[10]

Applying those principles, the Fifth Circuit concluded that the exculpatory provision could extend only to Highland Capital, as debtor, the creditors' committee and its members, and the independent directors for conduct in the scope of their duties.

The Fifth Circuit concluded that exculpation was permissible for the independent directors only because earlier orders in the bankruptcy proceedings had given those directors the power to act as the debtor's quasi-trustee, but the court took pains to limit its holding to that "unique governance structure," disclaiming any broader authority to exculpate nondebtors.[11]

Discussion

The Fifth Circuit's decision highlights a split of authority on bankruptcy courts' powers to

exculpate nondebtors and raises questions about other protections like gatekeeping that may apply to such parties.

These concerns may well reach beyond exculpation provisions and extend to nonconsensual third-party releases,[12] like those approved by the bankruptcy court in the In re: Purdue Pharma LP bankruptcy case now on appeal to the U.S. Court of Appeals for the Second Circuit.[13]

The circuit courts are divided on the meaning of Section 524(e).

The Fifth Circuit acknowledged that its decision in Highland Capital — along with its earlier decision in In re: Pacific Lumber Co. — represents a contested view of the bankruptcy court's powers: "The simple fact of the matter is that there is a circuit split concerning the effect and reach of [Section] 524(e)."[14]

Cataloging the cases, the Fifth Circuit explained that the Second, Third, Fourth, Sixth, Seventh, Ninth and Eleventh Circuits "allow varying degrees of limited third-party exculpations."[15]

Only the U.S. Court of Appeals for the Tenth Circuit agrees with the Fifth that Section 524(e) is a categorical bar to such exculpation.[16]

Other circuits considering this issue have read the text of Section 524(e) to be more permissive of nondebtor exculpation. As the Ninth Circuit has explained, because Section 524(e) speaks only about "affect[ing] the liability ... on ... such debt," it could be read not to reach the claims covered by exculpation provisions, which represent liability for conduct in the bankruptcy process, rather than liability for the underlying debt.[17]

Moreover, Section 524(e) could be read as a floor rather than a ceiling, i.e., as providing that a plan does not automatically affect third-party liability, without constraining the bankruptcy court's power to eliminate third-party liability when it deems a third-party release appropriate.[18]

That would be consistent with other courts' conclusions that Section 524(e) should not "be literally applied in every case as a prohibition" on "the equitable power of the bankruptcy court."[19] But as U.S. District Judge Colleen McMahon detailed in the ongoing Purdue Pharma litigation, the legislative history of Section 524 may cut both ways.[20]

Notably, the Fifth Circuit rejected Title 11 of the U.S. Code, Section 1123(b)(6) as a residual source of authority to exculpate third parties. That provision authorizes bankruptcy plans to include "any other appropriate provision not inconsistent with the applicable provisions" of the code.

Other courts have concluded that an exculpation provision may be an appropriate provision to include in a plan pursuant to these powers, at least where unusual circumstances warrant.[21] But the Fifth Circuit did not address those holdings.

Instead, it disposed of Section 1123(b)(6) in a single sentence, concluding that it does not provide the independent statutory authorization that the court viewed as required by Section 524(e).[22]

The Fifth Circuit's approval of gatekeeping provisions and existing powers to combat vexatious litigation may provide a limited workaround to the prohibition

on third-party exculpation.

Although the Fifth Circuit significantly curtailed the bankruptcy court's ability to approve exculpation provisions protecting nondebtor participants in a bankruptcy case, the court nonetheless approved the bankruptcy plan's gatekeeping provisions as lawful under governing U.S. Supreme Court precedent.[23]

The gatekeeping provisions approved in Highland Capital require that parties asserting claims against the exculpated parties first establish to the satisfaction of the bankruptcy court that such claims are colorable before asserting them in another forum.

While the gatekeeping provisions of the Highland Capital plan apply by their terms only to the exculpated parties, the Fifth Circuit expressly noted that nothing in the opinion should be construed to hinder the distinct power of a bankruptcy court to enjoin or impose sanctions against vexatious litigants.[24]

Moreover, the opinion does not address the availability of a gatekeeping provision with broader application to protect parties not entitled to exculpation from the threat of vexatious litigation, although such a provision could not restrict plaintiffs to asserting only claims for bad faith, fraud, gross negligence or similar misconduct against nonexculpated parties.

The appellants in Highland Capital warned that the gatekeeping provision would extend to claims over which the bankruptcy court lacks subject-matter jurisdiction.[25]

While acknowledging this might be the case, the Fifth Circuit noted that precedent required that it leave this question to the bankruptcy court to consider in the first instance.[26]

This lingering jurisdictional question may reduce confidence in the protections afforded by gatekeeping until the issue is further developed in the courts.

Conclusion

The immediate impact of the Fifth Circuit's opinion is uncertainty about post-petition legal exposure for officers and directors of Chapter 11 debtors — and insurers providing insurance coverage for such parties — who might otherwise expect such parties to be protected by a plan's exculpation and general release provisions.

By excluding a debtor's officers and directors from the protection of exculpation provisions, the Fifth Circuit's approach may increase the costs of insurance coverage and deter important stakeholders from participating in the reorganization process.

The unavailability of exculpation to protect officers and directors may also add a level of complexity and reduce creditor recoveries in particularly litigious cases by encouraging parties who can no longer obtain exculpation to seek reserves for potential administrative claims for indemnification that would otherwise be discharged in accordance with Section 1141(d)(1)(A).[27]

The opinion may also encourage the use of other tools, like gatekeeping, to provide some level of protection short of exculpation, although the uncertainty surrounding the scope of the protections provided by gatekeeping make them, at most, only a partial substitute for exculpation.

Given the division in authority surrounding these issues and potential consequences of the Fifth Circuit's approach, the Highland Capital decision is unlikely to be the last word on the permissible scope of exculpation and gatekeeping under Chapter 11 plans.

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[1] In re Highland Cap. Mgmt., L.P., No. 21-10449 (5th Cir. Aug. 19, 2022) ("Op.").

[2] Op. 7.

[3] Id.

[4] Id. at 4, 7, 26.

[5] Id. at 7-8.

[6] Op. 24 (citing In re Pac. Lumber, 584 F.3d 229, 252-53 (5th Cir. 2009)).

[7] 11 U.S.C. § 105(a) enables the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

[8] 11 U.S.C. § 1123(b)(6) allows a plan to "include any other appropriate provision not inconsistent with the applicable provisions of this title."

[9] Op. 25 (citing In re Oxford Mgmt., Inc., 4 F.3d 1329, 1334 (5th Cir. 1993); In re Zale Corp., 62 F.3d 746, 760 (5th Cir. 1995)).

[10] Id.

[11] Id. at 4, 26.

[12] See id. at 15 (analogizing between the two).

[13] See In re Purdue Pharma, L.P., 635 B.R. 26, 104 (S.D.N.Y. 2021), appeal pending, No. 22-110 (2d Cir. argued Apr. 29, 2022).

[14] Op. 23.

[15] Id. at 24.

[16] Id. at 23-24.

[17] Blixseth v. Credit Suisse, 961 F.3d 1074, 1082-83 (9th Cir. 2020), cert. denied, 141 S.

Ct. 1394 (2021).

[18] In re Airadigm Commc'ns, Inc., 519 F.3d 640, 656 (7th Cir. 2008); In re Dow Corning Corp., 280 F.3d 648, 657 (6th Cir. 2002) ("However, this [§ 524(e)] language explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor.").

[19] In re A.H. Robins Co., 880 F.2d 694, 702 (4th Cir. 1989).

[20] See Purdue, 635 B.R. at 92-94, 107-11 (suggesting that the enactment of § 524(g), concerning asbestos claims, weighs against non-consensual releases of non-debtors for other kinds of claims).

[21] Airadigm, 519 F.3d at 657; Dow, 280 F.3d at 658.

[22] Op. 25.

[23] Id. at 28-29 (citing Barton v. Barbour, 104 U.S. 126 (1881)).

[24] Id. at 30 n.19.

[25] Id. at 29 (citing In re Craig's Stores of Tex., Inc., 266 F. 3d 388, 390 (5th Cir. 2001) (explaining that the bankruptcy court's post-confirmation jurisdiction is limited to "matters pertaining to the implementation or execution of the plan")).

[26] Id.

[27] Courts have held that indemnification claims of officers and director arising exclusively from their post-petition conduct are entitled to administrative expense priority. In re Keene Corp., 208 B.R. 112, 116 (Bankr. S.D.N.Y. 1997); In re Heck's Props., Inc., 151 B.R. 739, 768 (S.D. W. Va. 1992). 11 U.S.C. § 1141(d)(1)(A) provides that confirmation of a plan discharges a debtor from any debt that arose prior to confirmation. Thus, absent the establishment of a reserve to satisfy potential administrative claims for officer and director indemnification, such claims would be discharged upon confirmation of a plan.

Faculty

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