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BUSINESS RESTRUCTURING REVIEW

U.S. SUPREME COURT: CREDITORS MAY IMMEDIATELY APPEAL DENIALS OF AUTOMATIC-STAY RELIEF

Christopher DiPompeo ■ Mark G. Douglas

On January 14, 2020, the U.S. Supreme Court held in *Ritzen Group, Inc. v. Jackson Masonry, LLC*, 589 U.S. ___, 2020 WL 201023 (Jan. 14, 2020), that bankruptcy court orders conclusively denying relief from the automatic stay (11 U.S.C. § 362(a)) are appealable. The decision provides important guidance to bankruptcy courts, practitioners, and parties on the oft-recurring issues of taking and preserving bankruptcy appeals.

When a land sale fell through, Ritzen Group sued Jackson Masonry in state court. Days before trial, Jackson filed for chapter 11 bankruptcy, which automatically stayed the state court litigation. Ritzen sought relief from the stay, which the bankruptcy court denied. Instead of appealing, Ritzen filed a proof of claim and pursued its contract dispute in an adversary proceeding in the bankruptcy court. That court ruled against Ritzen, disallowed its proof of claim, and confirmed a plan enjoining all creditors (including Ritzen) from suits related to prepetition claims.

Ritzen then filed two separate appeals—from the bankruptcy court's decision on its contract claims and from the court's denial of relief from the automatic stay. Both the district court and the Sixth Circuit held (consistent with the majority view of the circuits) that the order denying stay relief had been immediately appealable, which made Ritzen's appeal untimely. (Both courts also rejected Ritzen's contract claims.)

Justice Ginsburg delivered the opinion for a unanimous court, affirming on the question of appealability. The Court relied heavily on its 2015 opinion in *Bullard v. Blue Hills Bank*, 575 U.S. 496. In *Bullard*, as *Ritzen* explained, the Court had held that an order rejecting a proposed chapter 13 plan was not "final" under 28 U.S.C. § 158(a) because a motion to confirm a plan was one step in a broader "plan-confirmation process," and thus the order "did not conclusively resolve the relevant 'proceeding.'" Under *Bullard*, "orders in bankruptcy cases may be immediately appealed if they finally dispose of discrete disputes within the larger case," fixing the rights and obligations of the parties. 575 U.S. at 501.

Applying that rule, the Court in *Ritzen* held that, as a category, "the adjudication of a motion for relief from the automatic stay forms a discrete procedural unit within the embracive bankruptcy case," which makes an order conclusively resolving such a motion appealable—and made Ritzen's appeal untimely. The Court rejected Ritzen's argument that such

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orders are merely a preliminary step of an overall claims adjudication process, noting their potentially significant consequences. The Court also expressed its belief (in response to Ritzen's argument) that its decision would "avoid . . . 'delays and inefficiencies'" by allowing appellate consideration of automatic-stay issues as they occur (quoting *Bullard*, 575 U.S. at 504).

The Court's decision is important because the practical consequences of orders denying stay relief can be significant. For example, in large chapter 11 cases, secured creditors often move for relief from the automatic stay to obtain adequate protection for the value of their collateral during the bankruptcy case. If orders denying such motions were not immediately appealable, secured creditors might not be able to pursue appellate review as to their particular issues until the bankruptcy case ended, at which point the value of their collateral might have substantially diminished.

The *Ritzen* opinion also might further clarify other circumstances in which a contested matter will be sufficiently distinct to qualify under *Bullard* as an independent "proceeding" that, once finally decided, can—indeed, must—be immediately appealed. Even so, because stay-relief motions were a relatively easy application of *Bullard* (as the lower court decisions and the majority view of the circuits confirmed), the Court did not have to grapple much with the line between appealable and nonappealable orders; it merely reiterated, drawing on *Bullard*, that "disputes over minor details about how a bankruptcy case will unfold" would, of course, not be distinct proceedings.

Thus, questions of what amounts to "a discrete procedural unit," distinct from the "umbrella bankruptcy case" (*Ritzen*, 2020 WL 201023, at **2, 3), will remain (along with questions of finality). Absent on-point precedent or at least judicial consensus, it may be difficult to know whether a contested matter satisfies the rule of *Bullard*. Such uncertainty creates real risks because appellate deadlines are generally jurisdictional, *see Bowles v. Russell*, 551 U.S. 205 (2007), and so a failure to appeal can, as the Ritzen Group found, forfeit a later appeal. Parties thus may have an incentive to file appeals anytime a contested matter is resolved against them. As a result, *Ritzen* will likely not be the Supreme Court's final word on this topic.

TURF WAR UPDATE: SIXTH CIRCUIT WEIGHS IN ON DISPUTE BETWEEN BANKRUPTCY COURTS AND FERC OVER REJECTION OF POWER CONTRACTS

Paul M. Green ■ Mark G. Douglas

The recent chapter 11 filings by PG&E Corp. and its Pacific Gas & Electric Co. utility subsidiary (collectively, "PG&E") and FirstEnergy Solutions Corp. reignited the debate over the power of a U.S. bankruptcy court to authorize the rejection of contracts regulated by the Federal Energy Regulatory Commission ("FERC"). Only a handful of courts have addressed this thorny issue to date, and with conflicting results, in a controversy that may ultimately need to be resolved by the U.S. Supreme Court or legislative action. The crux of the problem lies in seemingly conflicting jurisdiction conferred by the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq.*, and related statutes upon bankruptcy courts to authorize the rejection of burdensome contracts, on the one hand, and by the Federal Power Act, 16 U.S.C. §§ 791a *et seq*. (the "FPA"), upon FERC, which is granted the "exclusive authority" to determine the reasonableness of interstate utility rates, on the other.

The U.S. Court of Appeals for the Sixth Circuit is the most recent court to weigh in on the debate, and only the second court of appeals to do so. In *FERC v. FirstEnergy Solutions Corp. (In re FirstEnergy Solutions Corp.)*, 945 F.3d 431 (6th Cir. 2019), a divided panel of the Sixth Circuit ruled that, although the bankruptcy court had "concurrent" jurisdiction to decide whether chapter 11 debtors could reject certain FERC-regulated wholesale power contracts, the bankruptcy court exceeded its jurisdiction by enjoining FERC from requiring the debtors to continue performing under the contracts or from taking any other actions in connection with them. The Sixth Circuit also held that the bankruptcy court incorrectly applied the "business-judgment" standard to the debtors' request to reject the contracts. According to the Sixth Circuit:

> [W]hen a Chapter 11 debtor moves the bankruptcy court for permission to reject a filed energy contract that is otherwise governed by FERC, via the FPA, the bankruptcy court must consider the public interest and ensure that the equities balance in favor of rejecting the contract, and it must invite FERC to participate and provide an opinion in accordance with the ordinary FPA approach . . . within a reasonable time.

BANKRUPTCY JURISDICTION AND REJECTION OF EXECUTORY CONTRACTS

By statute, U.S. district courts are given "original and exclusive" jurisdiction over every bankruptcy "case." 28 U.S.C. § 1334(a). In addition, they are conferred with nonexclusive jurisdiction over all "proceedings arising under" the Bankruptcy Code as well as those "arising in or related to cases under" the Bankruptcy Code. 28 U.S.C. § 1334(b). Finally, district courts are granted exclusive jurisdiction over all property of a debtor's bankruptcy estate, including, as relevant here, contracts, leases, and other agreements that are still in force when a debtor files for bankruptcy protection. 28 U.S.C. § 1334(e). That jurisdiction typically devolves automatically upon the bankruptcy courts, each of which is a unit of a district court, by standing court order. 28 U.S.C. § 157(a).

A bankruptcy court's exclusive jurisdiction over "executory" contracts or unexpired leases empowers it to authorize a bankruptcy trustee or chapter 11 debtor-in-possession ("DIP") to either "assume" (reaffirm) or "reject" (breach) almost any executory contract or unexpired lease during the course of a bankruptcy case in accordance with the provisions of section 365 of the Bankruptcy Code. Assumption generally allows the DIP to continue performing under the agreement, after curing outstanding defaults, or to assign the agreement to a third party for consideration as a means of generating value for the bankruptcy estate. Rejection frees the DIP from rendering performance under an unfavorable contract. Rejection constitutes a breach of the contract, and the resulting claim for damages is deemed to be a prepetition claim against the estate on a par with other general unsecured claims. *See* 11 U.S.C. § 365(g).

The power granted to debtors by Congress under section 365 is viewed as vital to the reorganization process. Rejection of a contract "can release the debtor's estate from burdensome obligations that can impede a successful reorganization." *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984) (holding that rejection is allowed for "all executory contracts except those expressly exempted"). Typically, bankruptcy courts authorize the proposed assumption or rejection of a contract or lease if it is demonstrated that the proposed course of action represents an exercise of sound business judgment. This is a highly deferential standard akin in many respects to the business-judgment rule applied to corporate fiduciaries.

THE FEDERAL POWER ACT, THE FILED-RATE DOCTRINE, AND THE MOBILE-SIERRA DOCTRINE

Public and privately operated utilities providing interstate utility service within the United States are regulated by the FPA under FERC's supervision. Although contract rates for electricity are privately negotiated, those rates must be filed with FERC and certified as "just and reasonable" in order to be lawful. 16 U.S.C. § 824d(a). FERC has the "exclusive authority" to determine the reasonableness of the rates. *See In re Calpine Corp.*, 337 B.R. 27, 32 (S.D.N.Y. 2006). The FPA authorizes FERC, after a hearing, to alter filed rates if it determines that they are unjust or unreasonable. 16 U.S.C. § 824e.

On the basis of this statutory mandate, courts have developed the "filed-rate doctrine," which provides that "a utility's right to a reasonable rate under the FPA is the right to the rate which the FERC files or fixes and, except for review of FERC orders, a court cannot provide a right to a different rate." *Calpine*, 337 B.R. at 32. Moreover, the doctrine prohibits any collateral attack in the courts on the reasonableness of rates—the sole forum for such a challenge is FERC. *Id.* Applying the doctrine, some courts have concluded that, once filed with FERC, a wholesale power contract is tantamount to a federal regulation, and the duty to perform under the contract comes not only from the agreement itself, but also from FERC. *Id.* at 33 (citing *Pa. Water & Power Comm'n v. Fed. Power Comm'n*, 343 U.S. 414 (1952); *Cal. ex rel. Lockyer v. Dynergy Inc.*, 375 F.3d 831 (9th Cir. 2004)).

Although FERC has exclusive authority to modify a filed rate, its discretion is not unfettered. For example, FERC may not change a filed rate solely because the rate affords the utility "less than a fair return" since "the purpose of the power given to the Commission … is the protection of the public interest,

as distinguished from the private interests of the utilities." *In re Mirant Corp.*, 378 F.3d 511, 518 (5th Cir. 2004) (citation omitted). In such a case, FERC can change a filed rate only when "the rate is so low as to adversely affect the public interest—as where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Id.*

In a series of cases (*see United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332 (1956); *Fed. Power Comm'n v. Sierra Pac. Power Co.*, 350 U.S. 348 (1956)), the U.S. Supreme Court articulated what is referred to as the "Mobile-Sierra doctrine." Under this doctrine, FERC must presume that a rate set by a freely negotiated wholesale energy contract meets the "just and reasonable" requirement of the FPA. That presumption may be overcome only if FERC concludes that the contract seriously harms the public interest. *See NRG Power Mktg., LLC v. Maine Pub. Utilities Comm'n*, 558 U.S. 165 (2010).

If a regulated utility files for bankruptcy, FERC's exclusive discretion in this realm could be interpreted to conflict with the bankruptcy court's exclusive jurisdiction to authorize the rejection of an electricity supply agreement. This thorny issue has been addressed to date by only a handful of courts and, with the Sixth Circuit's recent ruling, two federal courts of appeals.

MIRANT

In *Mirant*, the U.S. Court of Appeals for the Fifth Circuit ruled that the FPA does not prevent a bankruptcy court from ruling on a motion to reject a FERC-approved rate-setting agreement so long as the proposed rejection does not represent a challenge to the agreement's filed rate.

In the case before it, the Fifth Circuit explained, although the chapter 11 debtor's desire to reject a FERC-regulated power supply agreement was motivated in part by its below-market rate, the debtor's business justification was also premised on the existence of excess supply and the consequent lack of any need for the energy covered by the contract. The court accordingly concluded that rejection of the agreement was not a challenge to the filed rate and that the FPA did not preempt a ruling on the rejection motion.

The Fifth Circuit rejected FERC's argument that anything less than full payment would constitute a challenge to the filed rate. According to the court, "[A]ny effect on the filed rates from a motion to reject would result not from the rejection itself, but from the application of the terms of a confirmed reorganization plan to the unsecured breach of contract claims." The court also noted that, although the Bankruptcy Code places numerous limitations on a debtor's right to reject contracts, "including exceptions prohibiting rejection of certain obligations imposed by regulatory authorities," there is no exception that prohibits a debtor's rejection of wholesale electricity contracts that are subject to FERC's jurisdiction. Concluding that "Congress intended § 365(a) to apply to contracts subject to FERC regulation," the Fifth Circuit held that the bankruptcy court's power to authorize rejection of the agreement did not conflict with the authority conferred upon FERC to regulate rates for the interstate sale of electricity.

Citing the U.S. Supreme Court's ruling regarding the standard for rejecting a collective bargaining agreement in *Bildisco*, the Fifth Circuit in *Mirant* concluded that, in determining whether a debtor should be permitted to reject a wholesale power contract, "the business-judgment standard would be inappropriate ... because it would not account for the public interest inherent on the transmission and sale of electricity." Instead, a "more rigorous standard" might be appropriate, including consideration of not only whether the contract burdens the estate, but also whether the equities balance in favor of rejection, rejection would promote a successful reorganization, and rejection would serve the public interest. Such a balancing exercise, the Fifth Circuit noted, could be undertaken with FERC's input.

CALPINE

In *Calpine*, the U.S. District Court for the Southern District of New York, after withdrawing the reference to the bankruptcy court, dismissed a chapter 11 debtor's motion to reject certain power agreements because the court concluded that FERC had exclusive jurisdiction over the modification or termination of such agreements.

According to the court, the requirement that FERC approval be obtained for any alteration of the "rates, terms, conditions, or duration" of a power agreement is not eliminated merely because the power provider files for bankruptcy. The district court found "little evidence" in the Bankruptcy Code of congressional intent to limit FERC's regulatory authority, remarking that "[a]bsent overriding language, the Bankruptcy Code should not be read to interfere with FERC jurisdiction."

The court wrote that, if a bankruptcy court's broad powers and jurisdiction, including the power to authorize the rejection of a contract, conflict with a federal regulatory regime, "the power of the bankruptcy court must yield to that of the federal agency." The Bankruptcy Code itself supports this conclusion, the court explained, by exempting agency action from the scope of the automatic stay in section 362(b)(4).

As framed by the district court, the dispositive issue was whether rejection of the power agreements directly interfered with FERC's exclusive jurisdiction over wholesale power contracts "or otherwise constitutes a collateral attack on the filed rate." The court concluded that it would—rejection of the agreements, which even the debtor admitted was motivated by its dissatisfaction with their below-market rates, would infringe upon FERC's exclusive prerogative to regulate the rates, terms, conditions, and duration of wholesale energy contracts.

The district court explained that the Fifth Circuit's rationale in *Mirant* was entirely consistent with its own conclusions because in *Calpine*, unlike in *Mirant*, the debtor was seeking nothing more than rate relief—its rejection motion clearly stated that it needed relief from the power agreements because it was being forced to sell energy at far below market rates.

BOSTON GENERATING

In *In re Boston Generating, LLC*, 2010 WL 4616243 (S.D.N.Y. Nov. 12, 2010), the U.S. District Court for the Southern District of New York, after withdrawing the reference of the matter to the bankruptcy court, ruled that, in order to reject a contract for the transportation of natural gas to one of the chapter 11 debtors' power plants, the debtors "must also obtain a ruling from FERC that abrogation of the contract does not contravene the public interest."

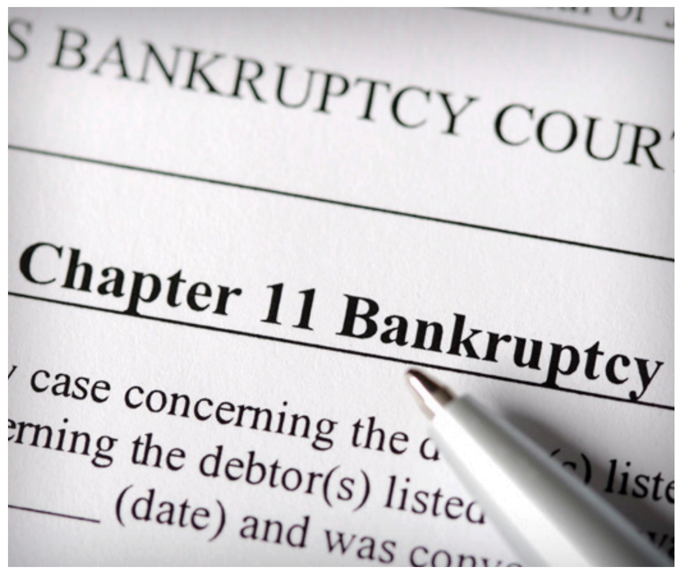
The parties to the contract agreed that the debtors should seek FERC approval of the proposed rejection, but they disagreed over whether the bankruptcy court could consider the rejection motion concurrently with FERC or would have to wait until FERC had ruled. According to the district court, the issue was of no consequence. "If either the bankruptcy court or FERC does not approve the Debtors' rejection of the [gas transportation agreement]," the court wrote, "the Debtors may not reject the contract."

PG&E

In *PG&E Corp. v. FERC (In re PG&E Corp.)*, 603 B.R. 471 (Bankr. N.D. Cal. June 7, 2019), *amended and direct appeal certified*, 2019 WL 2477433 (Bankr. N.D. Cal. June 12, 2019), the U.S. Bankruptcy Court for the Northern District of California ruled that the lack of any exception for FERC in section 365 of the Bankruptcy Code "simply means that FERC has no jurisdiction over the rejection of contracts."

PG&E filed for chapter 11 protection on January 29, 2019, in an effort to manage potential liabilities exceeding $30 billion arising from the alleged role of its equipment in sparking the largest wildfires in California history. At the time of the filing, PG&E was party to $42 billion worth of power purchase agreements (each, a "PPA"), with approximately 350 counterparties covering various electricity projects.

In anticipation of PG&E's bankruptcy filing, two PPA counterparties filed petitions with FERC seeking a declaration that if PG&E filed for bankruptcy, it could not abrogate, amend, or reject the PPAs without first obtaining FERC approval. FERC issued an order in January 2019 concluding that the "Commission and the bankruptcy courts have concurrent jurisdiction to review and address the disposition of wholesale power contracts sought to be rejected through bankruptcy." FERC stated that to "give effect to both the FPA and the Bankruptcy Code," a debtor that is a party to a FERC-regulated power purchase agreement must obtain approval from both FERC and the bankruptcy court to modify the filed rate and reject the contract.



After filing for bankruptcy, PG&E filed an adversary proceeding in the bankruptcy court seeking a declaratory judgment that the bankruptcy court had exclusive jurisdiction to decide whether PG&E could reject the PPAs, as well as an injunction blocking FERC from taking any action that would require PG&E to continue performing under PPAs that PG&E wanted to reject.

The bankruptcy court ruled that FERC exceeded its authority by declaring that it shares jurisdiction with the bankruptcy court over the question of whether PG&E can reject its PPAs. The court rejected FERC's argument that, because wholesale power contracts are not "simple run-of-the-mill contracts," but implicate the public interest in the orderly production of electricity at just and reasonable rates, the modification or abrogation of such contracts by means of rejection should not be subject to a bankruptcy court's exclusive jurisdiction. According to the court, this argument "is completely contrary to the congressionally created authority of the bankruptcy court to approve rejection of nearly every kind of executory contract," including "run-of-the-mill types" as well as power purchase agreements and other contracts that implicate the public's interest, with certain exceptions not relevant in this case (e.g., sections 365(h) (certain leasehold interests), 365(i) (timeshare interests), 365(n) (intellectual property licenses), 365(o) (commitments to federal depository institutions), and 1113 (collective bargaining agreements)). Those provisions, the court reasoned, demonstrate that Congress knows "how to craft special rules for special circumstances." The court added that lawmakers also knew how to condition confirmation of a chapter 11 plan on the approval by a governmental regulatory commission of any proposed rate change but failed to condition rejection of a contract on FERC's approval. *See* 11 U.S.C. § 1129(a)(6).

The bankruptcy court, concluding that there is no support in either the Bankruptcy Code or the FPA for FERC's assertion of jurisdiction, accordingly granted PG&E's motion for a declaratory judgment that: (i) FERC does not have concurrent jurisdiction over the court's decision to authorize PG&E to reject (or assume) the PPAs; and (ii) FERC's previous rulings involving PG&E are of no force and effect and are not binding on PG&E in its bankruptcy cases. Given its conclusion that FERC exceeded its statutory authority, the court declined to issue an injunction. However, the court wrote that, "[i]f necessary in the future[,] it will enjoin FERC from perpetuating its attempt to exercise power it wholly lacks."

The bankruptcy court stated that, should PG&E move to reject any of the PPAs, the court would consider whether public-policy interests are implicated. At that juncture, the court explained, it could assess whether rejection is warranted, without any "need or right for a second inquiry by a separate non-judicial body to be involved."

The bankruptcy court certified a direct appeal of its ruling to the U.S. Court of Appeals for the Ninth Circuit.

FIRSTENERGY SOLUTIONS

FirstEnergy Solutions Corp. and a subsidiary (collectively, "FES") sells electricity to retail and corporate customers as well as on exchange markets. Prior to filing for chapter 11 protection in 2018, FES entered into several PPAs, in part to satisfy its regulatory obligation to purchase a certain amount of renewable energy credits. The PPAs became financially burdensome to FES after energy prices decreased and energy credits became readily available. After selling its entire retail business, FES had no need for credits from the PPAs, with respect to which FES estimated it was losing $46 million annually.

In 2010, FES entered into a multiparty intercompany power agreement (the "ICPA") under which the signatories were obligated to purchase power from a regional supplier. As with the PPAs, when FES filed for bankruptcy, it no longer needed the electricity, which under the terms of the ICPA cost significantly more than the market rate and, according to FES's estimate, would likely result in a loss of approximately $268 million over the remaining term of the contract.

After filing for bankruptcy, FES commenced an adversary proceeding seeking: (i) a declaratory judgment that the bankruptcy court had the exclusive jurisdiction to decide whether FES could reject the PPAs and the ICPA; and (ii) an order enjoining FERC either from interfering with the intended rejection by ordering continued performance or from conducting any proceedings, hearings, or investigations concerning the contracts.

In opposing the proceeding, FERC argued that, reading the FPA and the Bankruptcy Code together, FERC maintains concurrent jurisdiction with bankruptcy courts over wholesale power agreements. Stated differently, consistent with the district court opinion in *Boston Generating*, FERC insisted that a debtor must seek both bankruptcy court approval to reject a wholesale power agreement and FERC approval to unilaterally change such an agreement.

The bankruptcy court in *FirstEnergy Solutions* rejected this argument. It ruled that:

(i) Any action by FERC to require continued performance by FES in a proceeding commenced before FERC by the counterparty seeking a determination that rejection of the agreements would violate the filed-rate doctrine was subject to the automatic stay.

(ii) In accordance with the Sixth Circuit's ruling in *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374 (6th Cir. 2001), the "police and regulatory power" exception to the stay under section 362(b)(4) of the Bankruptcy Code did not apply because the FERC proceeding was "undertaken principally to adjudicate private rights, with only an incidental public interest in the litigation."

(iii) If FERC were nevertheless to proceed on the basis that the section 362(b)(4) exception did apply, "that action would be a fool's errand because any order it might issue to compel the Debtors' performance . . . would, in substance, be designed to obtain or control the property of the estate and therefore, be void *ab initio*" under section 362(a)(3) of the Bankruptcy Code.

(iv) In the alternative, to "preserve its jurisdiction" over the agreements, the bankruptcy court had the power to enjoin continuation of the FERC proceeding under section 105(a) of the Bankruptcy Code, which empowers a bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]."

Notably, the bankruptcy court wrote that "[w]hile given the force of statute or regulation under applicable caselaw, . . . filed rate contracts remain contracts. They are not actual regulations, subject to notice-and-comment rulemaking processes, let alone actual federal statutes, that would lie outside the ambit of Section 365 simply by virtue of not being 'contracts' at all." Consistent with *Mirant*, the bankruptcy court in *FirstEnergy Solutions* also concluded that the filed-rate doctrine, the FPA, and FERC's regulatory authority are not offended by, and do not preempt, the bankruptcy court's exclusive jurisdiction over motions to reject executory power contracts and the treatment of rejection damages claims in bankruptcy cases.

Having concluded that it had exclusive jurisdiction to decide whether FES could reject the PPAs and the ICPA, the bankruptcy court applied the "business-judgment" standard in authorizing the FES to reject the contracts. The court reasoned that rejection was warranted because FES did not need the electricity and the contract rates were significantly above market. Notably, the court refused to "consider any public interest principles potentially implicated by the [FPA] and/or any alleged harm that rejection could cause [FES's] contract counterparties or consumers."

The bankruptcy court certified a direct appeal of its ruling to the Sixth Circuit.

THE SIXTH CIRCUIT'S RULING

A divided three-judge panel of the Sixth Circuit affirmed the bankruptcy court's decision in part, reversed in part, and remanded the case below for additional findings.

As an initial matter, the Sixth Circuit concluded that the ICPA and the PPAs "are not de jure regulations but, rather, ordinary contracts susceptible to rejection in bankruptcy." This is because "the public necessity of available and functional bankruptcy relief is generally superior to the necessity of FERC's having complete or exclusive authority to regulate energy contracts and markets." However, the court explained, the bankruptcy court's jurisdiction in this context is not exclusive but, rather, concurrent, albeit "primary or superior to FERC's position."

Next, the Sixth Circuit determined that "the bankruptcy court was not necessarily wrong" in ruling that actions that might be undertaken by FERC in connection with the ICPA and the PPAs were not excepted from the automatic stay under the police and regulatory power exception set forth in section 362(b)(4). According to the Sixth Circuit, the bankruptcy court improperly applied the public-policy test set forth in *Chao* in holding that FERC's interest in preventing rejection of any power contracts is and always will be substantially private and only incidentally public, thereby falling outside the scope of section 362(b)(4). Under *Chao*, the Sixth Circuit explained in *FirstEnergy Solutions*, the bankruptcy court should not have imposed an "absolute injunction against any FERC activity." Instead, the Sixth Circuit wrote, "*Chao* would permit FERC to proceed at its own risk with any actions over which it felt it had jurisdiction [subject to judicial review], such as holding hearings and making findings, and to issue orders that did not violate the bankruptcy stay or conflict with the bankruptcy court's orders."

However, the Sixth Circuit noted, on the basis of the particular facts of this case—i.e., the tiny amounts of energy covered by the contracts relative to the market, FES's small stake in the ICPA, and the lack of damages to the PPA counterparties relative to the anticipated disproportionate harm to other creditors—the bankruptcy court's conclusion that FERC failed the public-policy test necessary to avoid the stay was not in error.

Next, the Sixth Circuit held that the bankruptcy court "went too far" in invoking section 105(a) of the Bankruptcy Code as authority for prohibiting FERC "from taking *any* action whatsoever or to enjoin all of FERC's regulatory functions." According to the Sixth Circuit, although the *Mirant* court held that section 105(a) gave it the power to enjoin FERC from countermanding its order authorizing rejection, "*Mirant*'s overall holding is integrated or holistic, meaning that its determination that the bankruptcy court's authority was superior to FERC's factored in the conclusion of public-interest considerations in the standard . . . as a concurrent limitation on the bankruptcy court's authority."

Finally, taking a cue from *Mirant*, the Sixth Circuit held that "an adjusted standard," rather than the business-judgment standard, "best accommodates the concurrent jurisdiction between, and separate interests of, the Bankruptcy Code (court) and the FPA (FERC)." It accordingly remanded the case to the bankruptcy court with instructions to reconsider its ruling under this higher standard after giving FERC a reasonable time to provide an opinion on the public interest.

In an opinion concurring in part and dissenting in part, circuit judge Richard A. Griffin agreed with the majority that the bankruptcy court erred by using the business-judgment standard. However, he wrote that the majority's affirmance of the bankruptcy court's order enjoining FERC from issuing an order requiring FES to continue performing under the PPAs and the ICPA or limiting FES to seeking abrogation of the contracts under the FPA was "based on a flawed understanding of how filed rates operate under the FPA" and "conflicts with Congress's decision to deny federal-court jurisdiction over the abrogation or modification of a filed rate." According to Judge Griffin, the majority created a conflict between the Bankruptcy Code and the FPA where none exists, and then declared that the Bankruptcy Code is more important. Such an approach, he wrote, undermines the filed-rate doctrine and would permit "power companies [to] use bankruptcy to evade regulation in an industry for which Congress envisioned close, watchful oversight."

OUTLOOK

Courts have reached mixed conclusions regarding the power of a bankruptcy court to authorize the rejection of a regulated wholesale power contract in bankruptcy. However, although the two courts of appeals that have addressed this question disagree over whether it creates a jurisdictional conflict, they agree that FERC should play some role in determining whether such contracts can be rejected. It remains to be seen whether the Ninth Circuit will also endorse this view or take a different approach in *PG&E*. Any resulting circuit split may invite resolution of this important issue by the U.S. Supreme Court or legislative action.

On January 27, 2020, FERC filed a petition for rehearing of the Sixth Circuit's ruling in *FirstEnergy Solutions*. FERC argued that the majority opinion contravenes U.S. Supreme Court precedent that rates filed with FERC carry public-law obligations that are separate from private contractual obligations. FERC also claimed that *Mission Products Holdings Inc. v. Tempnology LLC*, 139 S. Ct. 1652 (May 20, 2019), in which the Supreme Court ruled that rejecting a contract in bankruptcy is a "breach" with damages to be determined by "non-bankruptcy contract law," indicates that debtors are not exempt from "generally applicable law."

The Sixth Circuit denied FERC's petition for rehearing on March 13, 2020.

POST-*MERIT*, THE SECOND CIRCUIT REAFFIRMS ITS RULING THAT STATE LAW AVOIDANCE CLAIMS ARE PREEMPTED BY THE SECTION 546(e) SAFE HARBOR

Brad B. Erens ■ Mark G. Douglas

In *In re Tribune Co. Fraudulent Conveyance Litig.*, 946 F.3d 66 (2d Cir. 2019), the U.S. Court of Appeals for the Second Circuit reaffirmed, notwithstanding the U.S. Supreme Court's ruling in *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883, 200 L. Ed. 2d 183 (2018), its 2016 decision that creditors' state law fraudulent transfer claims arising from the 2007 leveraged buyout ("LBO") of Tribune Co. ("Tribune") were preempted by the safe harbor for certain securities, commodities, or forward contract payments set forth in section 546(e) of the Bankruptcy Code. The Second Circuit concluded that a debtor may itself qualify as a "financial institution" covered by the safe harbor, and thus avoid the implications of *Merit*, by retaining a bank or trust company as an agent to handle LBO payments, redemptions, and cancellations.

THE SECTION 546(e) SAFE HARBOR

Section 546 of the Bankruptcy Code imposes a number of limitations on a bankruptcy trustee's avoidance powers, which include the power to avoid certain preferential and fraudulent transfers. Section 546(e) provides that the trustee may not avoid, among other things, a pre-bankruptcy transfer that is a "settlement payment" made "by or to (or for the benefit of) a . . . financial institution [or a] financial participant . . . , or that is a transfer made by or to (or for the benefit of)" any such entity in connection with a "securities contract," unless the transfer was made with the actual intent to hinder, delay, or defraud creditors. Thus, the section 546(e) "safe harbor" bars avoidance claims challenging a qualifying transfer unless the transfer was made with actual intent to hinder, delay, or defraud creditors, as distinguished from being constructively fraudulent because the debtor was insolvent at the time of the transfer (or became insolvent as a consequence) and received less than reasonably equivalent value in exchange.

Section 101(22)(A) of the Bankruptcy Code defines the term "financial institution" to include:

> [A] Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity *and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a "customer", as defined in section 741) in connection with a securities contract (as defined in section 741) such customer* . . . .

11 U.S.C. § 101(22)(A) (emphasis added).

The purpose of section 546(e) is to prevent "the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1 (1982). The provision was "intended to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." *Id.*

Prior to the Supreme Court's ruling in *Merit*, there was a split among the circuit courts of appeals concerning whether the section 546(e) safe harbor barred constructive fraud claims seeking to avoid transactions in which the financial institution involved was merely a "conduit" for the transfer of funds from the debtor to the ultimate transferee. The Second Circuit ruled that the safe harbor applied under those circumstances in *In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013). The Supreme Court resolved the circuit split in *Merit*.

THE SUPREME COURT'S RULING IN *MERIT*

In *Merit*, a unanimous Court held that section 546(e) does not protect transfers made through a "financial institution" to a third party, regardless of whether the financial institution had a beneficial interest in the transferred property. Instead, the relevant inquiry is whether the transferor or the transferee in the transaction sought to be avoided is itself a financial institution. Because the selling shareholder in the LBO transaction that was challenged as a constructive fraudulent transfer in *Merit* was not a financial institution (even though the conduit banks through which the payments were made met that definition), the Court ruled that the payments fell outside the safe harbor.

In a footnote, the Court acknowledged that the Bankruptcy Code defines "financial institution" broadly to include not only entities traditionally viewed as financial institutions, but also the "customers" of those entities, when financial institutions act as agents or custodians in connection with a securities contract. The selling shareholder in *Merit* was a customer of one of the conduit banks, yet never raised the argument that it therefore also qualified as a financial institution for purposes of section 546(e). For this reason, the Court did not address the possible impact of the shareholder transferee's customer status on the scope of the safe harbor. The Second Circuit considered this question in *Tribune*.

TRIBUNE

In 2007, Tribune was the target of an LBO that paid its shareholders more than $8 billion in exchange for their shares in the company. There were two separate parts to the transaction. First, Tribune transmitted the cash necessary to purchase its shares in connection with a tender offer to a depositary, Computershare Trust Company, N.A. ("CTC"). CTC then accepted and held tendered shares on Tribune's behalf and paid selling shareholders $34 per share. Second, with CTC acting in the same capacity, Tribune purchased its remaining shares and borrowed an additional $3.7 billion in a go-private merger with a newly formed Tribune entity.

Shortly after the LBO was completed in December 2007, Tribune experienced financial difficulties due to declining advertising revenues and its failure to meet projections. The company filed for chapter 11 protection in December 2008 in the District of Delaware.

In 2010, Tribune's unsecured creditors' committee (the "Committee") sued Tribune's former shareholders and certain other defendants in the bankruptcy court to, among other things, avoid and recover the LBO payments as fraudulent transfers under sections 548(a) and 550 of the Bankruptcy Code. In 2011, finding that Tribune's various creditors (collectively, the "Creditors") regained the right to pursue *state law* constructive fraudulent transfer claims against the selling shareholders because such claims had not been asserted on behalf of Tribune's estate prior to expiration of the statute of limitations under section 546(a), the bankruptcy court modified the automatic stay to permit the Creditors' prosecution of lawsuits asserting such state law claims in state and federal courts. Beginning in December 2011, approximately 40 state and federal cases involving more than 5,000 defendants, including the litigation commenced by the Committee, were consolidated in the U.S. District Court for the Southern District of New York.

The bankruptcy court confirmed Tribune's chapter 11 plan in July 2012. The plan assigned the federal avoidance claims asserted by the Committee to a litigation trust. Thus, the litigation trustee became the successor plaintiff in that litigation. The plan did not assign the Creditors' state law constructive fraudulent transfer claims to the litigation trust.

In September 2013, the district court in the consolidated avoidance litigation granted a motion to dismiss the Creditors' state law constructive fraudulent transfer claims, finding that the automatic stay deprived individual creditors of standing to challenge the same transactions that the litigation trustee was simultaneously seeking to avoid. The Second Circuit affirmed on appeal, but on different grounds, holding that such claims were preempted by the section 546(e) safe harbor. According to

the Second Circuit, even though section 546(e) expressly provides that "the trustee" may not avoid certain payments under securities contracts unless such payments were made with the actual intent to defraud, section 546(e)'s language, its history, its purposes, and the policies embedded in the securities laws and elsewhere led to the conclusion that the safe harbor was intended to preempt constructive fraudulent transfer claims asserted by creditors. *See Deutsche Bank Trust Co. Ams. v. Large Private Beneficial Owners (In re Tribune Co. Fraudulent Conveyance Litig.)*, 818 F.3d 98 (2d Cir. 2016) ("*Tribune 1*").

On April 3, 2018, the Supreme Court issued an order that, in light of its recent ruling in *Merit*, the Court would defer consideration of the Creditors' petition seeking review of *Tribune 1*. According to the Supreme Court, deferring consideration of whether the Court should review the merits of the Second Circuit's decision "will allow the Court of Appeals or the District Court to consider whether to recall the mandate, entertain a . . . motion to vacate the earlier judgment, or provide any other available relief in light of this Court's decision in [*Merit*]." *See Deutsche Bank Trust Co. Ams. v. Robert R. McCormick Foundation*, 138 S. Ct. 1162, 2018 WL 1600841 (U.S. Apr. 3, 2018).

In May 2018, the Second Circuit issued an order suspending the effectiveness of *Tribune 1* "in anticipation of further panel review." The order neither vacated the underlying decision nor established a schedule for further review.

THE SECOND CIRCUIT'S REVISED RULING

In a revised opinion issued on December 19, 2019 ("*Tribune 2*"), two of the three judges on the panel that issued *Tribune 1* reaffirmed the court's previous decision that the Creditors' state law constructive fraudulent transfer claims were preempted by the section 546(e) safe harbor.

The Second Circuit panel acknowledged that one of the holdings in *Tribune 1* (as well as its previous ruling in *Quebecor*) was abrogated by *Merit*'s pronouncement that the section 546(e) safe harbor does not apply if a financial institution is a mere conduit. However, with certain significant exceptions, the Second Circuit otherwise restated verbatim much of its 2016 opinion concerning the safe harbor, including its determinations that the LBO payments were made "in connection with a securities contract" and that section 546(e) barred the Creditors' state law avoidance claims. The Second Circuit reached the same conclusion concerning the scope of section 546(e), but for a different reason.

The Second Circuit explained that, under *Merit*, the payments to Tribune's shareholders are shielded from avoidance under section 546(e) only if either Tribune, which made the payments, or the shareholders who received them were "covered entities." It then concluded that Tribune was a "financial institution," as defined by section 101(22)(A) of the Bankruptcy Code, and "therefore a covered entity."

According to the Second Circuit, CTC, which Tribune retained to act as depositary in connection with the LBO, is a "financial institution" for purposes of section 546(e) because it is a trust company and a bank. Therefore, the court explained, Tribune was likewise a financial institution because, under the ordinary meaning of the term, Tribune was CTC's "customer" with respect to the LBO payments, and CTC was Tribune's agent according to the common-law definition of "agency." "Section 546(e)'s language is broad enough under certain circumstances," the Second Circuit wrote, "to cover a bankrupt firm's LBO payments even where, as here, that firm's business was primarily commercial in nature."

Finally, the Second Circuit panel limited *Merit* to its facts, noting that the case did not address preemption but, instead, discussed whether the relevant transfer for purposes of section 546(e) "was the overarching transfer or any of its component transfers." Moreover, the Second Circuit found nothing in *Merit*'s reasoning to contradict its assessment of Congress's preemptive intent. It was unpersuaded by the Creditors' argument that the Supreme Court in *Merit* rejected "a primary premise" of the Second Circuit's ruling—namely, "that section 546(e) was intended to promote finality in the securities markets" (internal quotation marks omitted). According to the Second Circuit, in *Merit*, the Court "merely concluded that, to the extent the policies animating Section 546(e) were relevant for determining the safe harbor's scope, those policies did not supply a basis for 'deviat[ing] from the plain meaning of the language used in § 546(e)'" (citing *Merit*, 138 S. Ct. at 897, 888). In addition, the Second Circuit explained, *Merit* does not contradict its findings that the Creditors' legal theory: (i) has no support in the language of the Bankruptcy Code; (ii) leads to "substantial anomalies and conflicts" with the Bankruptcy Code's procedures; and (iii) "requires reading Section 546(e)'s reference to a trustee et al. avoidance claim to mean that creditors could bring their own claims—a reading that is less than plain."

OUTLOOK

Merit potentially opened the door for constructive fraudulent transfer claims against selling shareholders in many LBOs. Such payments typically pass through financial intermediaries that would be considered "financial institutions" and were previously considered to be protected from avoidance by the safe harbor in many circuits.

In handing down its ruling in *Tribune 2*, the Second Circuit employed substantially the same reasoning articulated by the U.S. District Court of the Southern District of New York in denying a litigation trustee's motion in a related lawsuit to amend the complaint, ruling that the proposed amendment would be futile because the federal constructive fraudulent transfer claims were barred by section 546(e). *See In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786 (S.D.N.Y. Apr. 23, 2019). The decisions of both the district court and the Second Circuit in *Tribune 2* suggest that the results of *Merit* might be avoided by structuring transactions such that the LBO target is a "customer" of the financial intermediaries involved.

The Creditors filed a petition for rehearing *en banc* of *Tribune 2* on January 2, 2020. The Creditors have challenged, among other things, the Second Circuit's conclusion that CTC was an agent for Tribune. The court denied the petition on February 6.

UNIFORM VOIDABLE TRANSACTIONS ACT ADOPTED IN NEW YORK

Mark G. Douglas

On July 16, 2014, the Uniform Law Commission (the "Commission") approved a series of amendments to the Uniform Fraudulent Transfer Act (the "UFTA"), which at that time was in force in 43 states (all states except Alaska, Kentucky, Louisiana, Maryland, New York, South Carolina, and Virginia). The revised model legislation, which has been enacted by 21 states (and introduced in four others), is now called the "Uniform Voidable Transactions Act" (the "UVTA").

New York State, which for 95 years had refrained from adopting the UFTA in favor of the Uniform Fraudulent Conveyance Act (the "UFCA"), formally adopted the UVTA on December 6, 2019. *See* N.Y. Debt. & Cred. Law §§ 270–281 (2019) (the "NY-UVTA"). The effective date of the NY-UVTA is April 4, 2020. With respect to transfers made and obligations incurred on or after that date, New York's voidable transactions law will be substantially similar to the fraudulent transfer laws in force in many other states.

AMENDMENTS TO THE UFTA IN THE UVTA

The changes to New York's previous fraudulent transfers law (the "NY-UFCA") can be understood by examining how the UVTA amended the UFTA and how the NY-UVTA differs from the NY-UFCA.

The UVTA is intended to: (i) address judicial inconsistency in applying the law; (ii) better harmonize with the Bankruptcy Code and the Uniform Commercial Code (the "UCC"); and (iii) provide litigants with greater certainty in its application.

The driving force behind the change is the concept of "constructive fraud," which permits the avoidance of transfers made or obligations incurred by an insolvent debtor in exchange for less than "reasonably equivalent value." Although denominated as "fraud," a constructively fraudulent transfer involves neither fraud nor improper intent, creating confusion among some courts that have issued rulings improperly limiting the scope of the avoidance remedy.

To address these concerns, the word "fraud" has been supplanted by the term "voidable" in nearly every portion of the UVTA and the Commission's official comments. Moreover, the UVTA adopts the more aggressive view that even "actually fraudulent" transfers do not require fraud. In lieu of the traditional standard applied to transfers made with the intent to "hinder, delay or defraud" creditors, the comments to the UVTA shift the inquiry to "hinder or delay" and substitute the idea of "unacceptably contraven[ing] norms of creditors' rights" as the measure for when efforts to hinder or delay render a transaction voidable.

In addition, the UVTA makes other key changes, including the following:

- **Burden of Proof.** The UVTA explicitly states that a creditor challenging a transfer bears the burden of establishing the elements of its claim by a preponderance of the evidence, rather than the higher "clear and convincing evidence" standard applied by some courts under the UFTA (and the UFCA). Furthermore, the official comments caution that courts should not alter the allocation of the burdens or apply any nonstatutory presumptions to avoid upsetting the uniformity of the UVTA.
- **Presumption of Insolvency.** The UFTA provided a rebuttable presumption that a debtor is insolvent if it fails to pay debts as they mature. The UVTA refines this presumption by: (i) clarifying, consistent with section 303(h)(1) of the Bankruptcy Code, that any nonpayment of debts subject to "bona fide dispute" is not presumptive of insolvency; and (ii) expressly providing that the burden to rebut this presumption falls on the "party against whom the presumption is directed," conforming to the treatment of rebuttable presumptions in the Uniform Rules of Evidence.
- **Safe Harbor.** The UFTA shields from avoidance transfers that resulted from the enforcement of a security interest in accordance with Article 9 of the UCC. The UVTA, however, carves out "strict foreclosures"—in which a debtor consents to the secured creditor's acceptance of collateral in full or partial satisfaction of the obligation, without a public sale or judicial foreclosure—from this defense to an avoidance action. Even so, the secured creditor may still ward off avoidance under the UVTA by demonstrating that a foreclosure sale was conducted in good faith and in a commercially reasonable manner.
- **Choice of Law.** The UVTA defuses potential choice of law disputes by including a governing law rule consistent with that of Article 9 of the UCC. The UVTA provides that the law of a business debtor's place of business or, if business is conducted in more than one state, the place in which the business had its chief executive office, at the time that a transfer was made, applies to claims under the UVTA. An important difference between the UVTA and the UCC, however, is that under the UCC, the location of a business that is a "registered organization" is always its state of organization, which may not be the state in which its business is conducted or the site of its chief executive office.

OTHER DIFFERENCES BETWEEN THE NY-UFCA AND THE NY-UVTA

There are several other material differences between the NY-UFCA and the NY-UVTA, including:

- **Reasonably Equivalent Value Standard for Constructive Fraudulent Transfers.** The "fair consideration" standard applied under the NY-UFCA to constructive fraudulent conveyances has been replaced in the NY-UVTA by the "reasonably equivalent value" standard that applies to such transfers under the Bankruptcy Code and the UFTA. Thus, the good faith requirement that was a component of the "fair consideration" standard under the NY-UFCA will no longer apply.
- **Reduction of Reach-Back Period.** Consistent with the UFTA and the UVTA, the general reach-back period for voidable transaction claims under the NY-UVTA will be reduced to four years from six years. In addition, the "discovery rule" governing intentional fraudulent transfers extends the limitations period for no more than one year after a transfer or obligation was or could reasonably have been discovered by the party challenging the transfer. Any untimely claim for relief is "extinguished."
- **Transfers to Insiders for Antecedent Debt.** The NY-UVTA provides that a transfer made by a debtor to a pre-existing creditor is voidable if the transfer was made to an "insider" for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent. The reach-back period for such an avoidance claim is one year. Notably, although section 547(b)(4)(B) of the Bankruptcy Code also has a one-year reach-back period for insider preference claims, that provision does not require proof that the insider had reasonable cause to believe that the debtor was insolvent.
- **Insider Avoidance Claim Defenses.** The NY-UVTA creates certain defenses to insider avoidance claims, some of which are similar to preference defenses under section 547(c) of the Bankruptcy Code. For example, under the NY-UVTA, an insider is insulated from an avoidance claim: (i) to the extent it gave new value to the debtor after the transfer was made, except to the extent the new value was secured by a valid lien; or (ii) if the transfer was made in the ordinary course of business or financial affairs of the debtor and the insider. However, unlike the Bankruptcy Code's insider preference defenses, the NY-UVTA would appear to insulate from avoidance a lien granted to an insider to secure an antecedent debt, provided it also secures present value given by the insider to the debtor in a good faith effort to rehabilitate the debtor.

IN *MILLENNIUM*, THE THIRD CIRCUIT GIVES NONCONSENSUAL THIRD-PARTY RELEASES IN A CHAPTER 11 PLAN A *STERN* LOOK

Andrew M. Butler

Nonconsensual third-party releases continue to attract attention in the busiest business bankruptcy forums in the country. In a long-anticipated opinion, *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126 (3d Cir. 2019), the U.S. Court of Appeals for the Third Circuit upheld a bankruptcy court decision confirming a chapter 11 plan containing nonconsensual third-party releases. The Third Circuit has not yet given such releases its wholesale approval—this opinion simply held that the bankruptcy court's order confirming the plan did not violate Article III of the U.S. Constitution. In fact, the Third Circuit made sure to emphasize the limited nature of its holding. With this ruling, however, the Third Circuit has finally weighed in on an important—although rarely discussed—aspect of the nonconsensual third-party release framework.

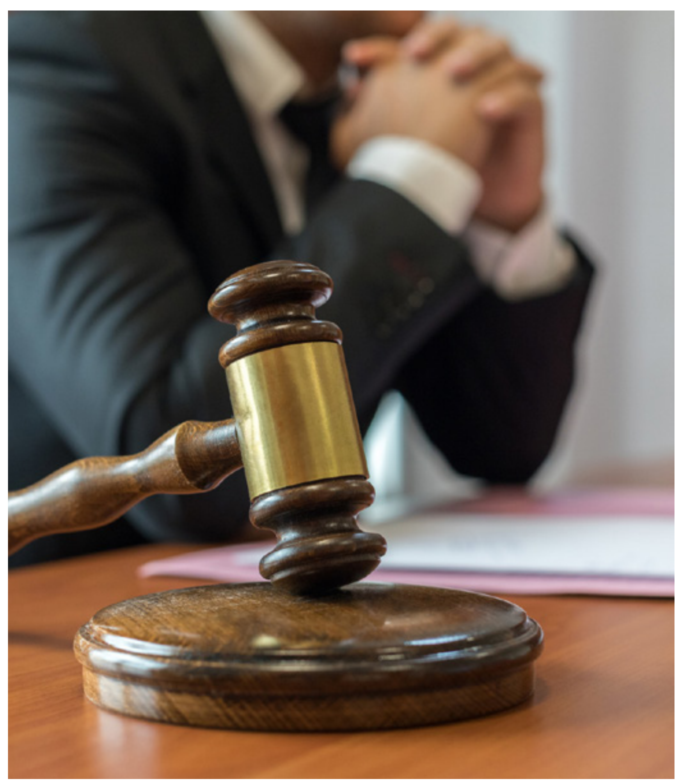
VALIDITY OF NONCONSENSUAL THIRD-PARTY RELEASES IN CHAPTER 11 PLANS

The circuit courts of appeals are split as to whether a bankruptcy court has the authority to approve chapter 11 plan provisions that, over the objection of creditors or other stakeholders, release specified nondebtors from liability and/or enjoin dissenting stakeholders from asserting claims against such nondebtors. The minority view, held by the Fifth, Ninth, and Tenth Circuits, bans such nonconsensual releases on the basis that they are prohibited by section 524(e) of the Bankruptcy Code, which provides generally that "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." *See Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009); *In re Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995); *In re W. Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990); *see also Zacarias v. Stanford International Bank Ltd.*, 945 F.3d 883 (5th Cir. 2019) (third parties making substantial contributions to the receiver in the R. Allen Stanford Ponzi scheme are entitled to an order barring creditors from suing on the creditors' claims), *petition for rehearing en banc denied*, No. 17-11073 (5th Cir. Jan. 21, 2020).

By contrast, the majority of the circuits that have considered the issue—the Second, Fourth, Sixth, Seventh, and Eleventh Circuits—have found such releases and injunctions permissible under certain circumstances. *See In re Drexel Burnham Lambert Grp., Inc.*, 960 F.2d 285 (2d Cir. 1992); *In re A.H. Robins Co., Inc.*, 880 F.2d 694 (4th Cir. 1989); *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002); *In re Airadigm Commc'ns, Inc.*, 519 F.3d 640 (7th Cir. 2008); *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir. 2015). For authority, these courts generally rely on section 105(a) of the Bankruptcy Code, which authorizes courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." Moreover, as the Seventh Circuit held in *Airadigm*, the majority view is that section 524(e) does not limit a bankruptcy court's authority to grant such releases.

The First and D.C. Circuits have suggested that they agree with the "pro-release" majority. *See In re Monarch Life Ins. Co.*, 65 F.3d 973 (1st Cir. 1995) (a debtor's subsidiary was collaterally estopped by a plan confirmation order from belatedly challenging the jurisdiction of the bankruptcy court to permanently enjoin lawsuits against the debtor's attorneys and other nondebtors not contributing to the debtor's reorganization); *In re AOV Indus.*, 792 F.2d 1140 (D.C. Cir. 1986) (a plan provision releasing liabilities of nondebtors was unfair because the plan did not provide additional compensation to a creditor whose claim against the nondebtor was being released; adequate consideration must be provided to a creditor forced to release claims against nondebtors). The Third Circuit declined to decide the issue in *In re Continental Airlines*, 203 F.3d 203 (3d Cir. 2000), ruling that a plan release provision did not pass muster under even the most flexible tests for the validity of nondebtor releases.

Majority-view courts employ various tests to determine whether such releases are appropriate. Factors generally considered by courts evaluating third-party plan releases or injunctions include whether they are essential to the reorganization, whether the parties being released have made or are making a substantial financial contribution to the reorganization, and whether affected



creditors overwhelmingly support the plan. *See Dow Corning Corp.*, 280 F.3d at 658 (listing factors).

The Third Circuit had another opportunity to weigh in on the validity of nondebtor plan releases in *Millennium*.

MILLENNIUM

In 2014, laboratory testing company Millennium Lab Holdings II, LLC ("Millennium") entered into a $1.8 billion credit agreement with lenders. Millennium then used the proceeds from the credit agreement to refinance existing debt and to pay a nearly $1.3 billion special dividend to its shareholders.

In 2015, following a federal investigation, Millennium reached a $256 million settlement with the Department of Justice, Medicare, and Medicaid regarding alleged violations of various laws. Shortly thereafter, Millennium concluded that it was unable to pay this settlement amount while also servicing its debt obligations under the 2014 credit agreement. Millennium then filed a chapter 11 petition in the District of Delaware, along with a prepackaged plan providing for prepetition shareholders to contribute $325 million in return for releases of claims by Millennium's lenders. The plan did not permit the lenders to opt out of the releases.

One of the lenders, Voya Investment Management Co. LLC ("Voya"), objected to confirmation of the plan. Voya intended to sue prepetition shareholders and company executives for alleged misrepresentations made as part of the 2014 financing transaction. Voya argued that the bankruptcy court did not have subject matter jurisdiction to approve nonconsensual third-party releases. Bankruptcy judge Laurie Selber Silverstein overruled Voya's objections and confirmed the plan. Voya appealed the confirmation order, arguing on appeal that the bankruptcy court lacked constitutional authority to order the releases. In addition, shortly after confirmation, Voya sued the prepetition shareholders in federal district court, alleging racketeering, fraud, and related claims. Voya's district court suit was stayed pending the appeal of the confirmation order.

The District Court Remand. The appellees, all of whom were named as released parties in the confirmed plan, moved to dismiss on the basis that the appeal was equitably moot because, among other things, Millennium's chapter 11 plan had been substantially consummated and granting the relief sought by Voya would lead to profoundly inequitable results. Chief judge Leonard P. Stark of the U.S. District Court for the District of Delaware remanded the case below, directing the bankruptcy court to consider whether it had constitutional authority to confirm a plan releasing Voya's claims in light of the U.S. Supreme Court's decision in *Stern v. Marshall*, 564 U.S. 462 (2011). In *Stern*, the Supreme Court articulated a "disjunctive test" for whether a bankruptcy court can enter a final order on a state law counterclaim of the bankruptcy estate: "Congress may not bypass Article III [of the U.S. Constitution] simply because a proceeding may have some bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself *or* would necessarily be resolved in the claims allowance process." *Stern*, 564 U.S. at 499 (emphasis added). The Court ruled that a bankruptcy court cannot enter a final judgment on a state law counterclaim of the bankruptcy estate that is not resolved in the process of ruling on a creditor's proof of claim.

The district court's remand decision in *Millennium* thus appeared to question whether the bankruptcy court had constitutional power to enter a final order because the releases were "tantamount to resolution of those claims on the merits."

The Bankruptcy Court's Opinion on Remand. On remand, Judge Silverstein concluded that *Stern* is inapplicable when the proceeding at issue is confirmation of a chapter 11 plan. And even if *Stern* did apply, the bankruptcy court said, *Stern*'s limitations would be satisfied. Voya appealed this second decision to the district court, and Millennium again moved to dismiss the appeal as being equitably moot.

The District Court's Second Opinion. The district court agreed that *Stern* is inapplicable to plan confirmation proceedings and affirmed the bankruptcy court's holding. The district court did not fault the bankruptcy court's conclusion that approval of the chapter 11 plan releases did not amount to adjudication on the merits of Voya's racketeering and related claims. Like the bankruptcy court, the district court noted that Voya's position was at best "a substantive argument against third party releases, not an argument that confirmation orders containing releases must be entered by a district court."

The district court also dismissed the remainder of Voya's appeal as equitably moot because: (i) the releases were central to the plan; (ii) removing the releases would undo the basic deal embodied in the plan; and (iii) Voya should not be permitted to benefit from the restructuring while simultaneously pursuing claims against the prepetition shareholders that such shareholders paid to settle by making a $325 million contribution to Millennium's reorganization. The district court also reasoned that even if it was wrong on these issues, it would still affirm the confirmation order by rejecting Voya's challenges on the merits. Voya appealed to the Third Circuit.

THE THIRD CIRCUIT'S RULING

A three-judge panel of the Third Circuit affirmed the district court's ruling.

Circuit judge Kent A. Jordan wrote for the panel and focused the constitutional analysis on *Stern*'s "two-part disjunctive test." As noted above, the test asks whether the bankruptcy court's ruling "stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern*, 564 U.S. at 499. Therefore, bankruptcy courts may constitutionally decide issues "integral to the restructuring of the debtor-creditor relationship."

Applying these principles, Judge Jordan ruled that the bankruptcy court had constitutional authority to confirm the plan with the release provisions. The record below established that the releases were "critical to the success of the Plan," the releases were "necessary to both obtaining the funding and consummating a plan," and "without [prepetition shareholders'] contributions, there [would be] no reorganization." As a consequence, Judge Jordan had no trouble concluding that the restructuring in Millennium's bankruptcy case "was possible only because of the release provisions."

Voya argued that providing the prepetition shareholders and company executives with releases, against the prepetition lenders' wishes, would open the floodgates to third-party releases. Judge Jordan acknowledged that this argument was "not without force" and that demands for releases by "reorganization financers . . . could lead to gamesmanship." In apparent response to such concerns, the judge attempted to limit how widely the court's opinion can be applied. For example, he noted that the opinion "should not be read as expanding bankruptcy court authority" nor as "permitting or encouraging . . . hypothetical gamesmanship." Judge Jordan also refrained from endorsing nonconsensual third-party releases wholesale. Consistent with precedent, he wrote, the Third Circuit is "not broadly sanctioning the permissibility of nonconsensual third-party releases in bankruptcy reorganization plans." Indeed, the holding is premised on the "specific, exceptional facts of this case."

The Third Circuit ultimately affirmed the bankruptcy court's constitutional power to approve nonconsensual third-party releases in a plan of reorganization because "the release provisions were integral to the restructuring[, and the bankruptcy court's conclusion] was well-reasoned and well-supported by the record."

The Third Circuit also affirmed the lower courts' ruling that Voya's appeal was equitably moot because, among other things, granting Voya's requested relief—which would, in essence, permit Voya to sue the prepetition shareholders—would "scramble the plan," and any attempt to unwind the plan would likely be impossible.

OBSERVATIONS AND CONCLUSION

The Third Circuit has now determined that a bankruptcy court may approve nonconsensual third-party releases in a chapter 11 plan under the U.S. Constitution. Although the Third Circuit attempted to limit the opinion's applicability, litigants in lower courts are likely to rely on the opinion to bolster arguments in favor of nonconsensual third-party plan releases. Voya filed a petition on March 24, 2020, seeking review of the Third Circuit's decision by the Supreme Court. As the circuit split on third-party releases continues, the likelihood increases that the Court will step in to resolve at least some of the issues that are presented.

NEWSWORTHY

Heather Lennox (Cleveland and ***New York)***, ***Ben Larkin (London)***, ***Bruce Bennett (Los Angeles*** and ***New York)***, and ***Corinne Ball (New York)*** have been recommended as "Leaders in Their Field" in the area of "Restructuring/Insolvency" or "Bankruptcy/Restructuring" by *Chambers Global 2020*.

An article written by ***Corinne Ball (New York)*** titled "Seventh Circuit Holds Interim DIP Financing Order Is Enforceable and Prior to Reclamation Claims Under § 546(c)" was published in the February 26, 2020, edition of the *New York Law Journal*.

An article written by ***Brad B. Erens (Chicago)*** and ***Mark G. Douglas (New York)*** titled "Chapter 11 Plan Distributions Are Not Collateral Covered by Intercreditor Agreement's Waterfall Provision" was posted on the January 28, 2020, *Harvard Law School Bankruptcy Roundtable*.

An article written by ***Brad B. Erens (Chicago)*** and ***Mark G. Douglas (New York)*** titled "Private Equity Update: 1st Circuit Reverses Imposition of Pension Plan Withdrawal Liability" was published by *Lexis Practice Advisor* on January 22, 2020.

An article written by ***Paul M. Green (Houston)*** and ***Mark G. Douglas (New York)*** titled "Oil and Gas Industry Update—*Sabine Oil* Not the Last Word on Treatment of Gathering Agreements in Bankruptcy" was published by *Lexis Practice Advisor* on January 22, 2020.

An article written by ***Dan T. Moss (Washington)*** and ***Mark G. Douglas (New York)*** titled "Chapter 15 Gap Period Relief Subject to Preliminary Injunction Standard But No Adversary Proceeding Required" was published in the January 2020 *INSOL International News Update*.

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Executive Editor: Charles M. Oellermann
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