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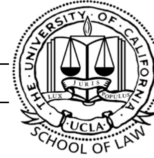

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Re: Bussel, Skeel & Harner, BANKRUPTCY (11th ed.) / 2022 Update

Dear Adopters:

We write to inform you of certain legislative and caselaw developments since the 2021 publication of the Eleventh Edition that you may wish to reference in your 2022-23 courses.

A. Subchapter V.

On the legislative front, Congress (finally, after a three-month interregnum) reinstated the increased CARES Act debt limit for "small business debtors" eligible for subchapter V relief to $7.5 million in noncontingent liquidated debts to third party creditors. *The Bankruptcy Threshold Adjustment and Technical Corrections Act*, P.L. 117-151 (Eff. June 21, 2022). The increase is effective for two years. At the same time, Congress raised the chapter 13 debt limit for individuals to $2.75 million aggregate of secured and unsecured debt. Under previous law the chapter 13 limit was $465,000 in unsecured and $1.4 million in secured debt.

More broadly, subchapter V has been very favorably received across the Nation as providing a workable reorganization alternative for small business debtors that could not bear the delays, expense and rigorous statutory requirements of traditional chapter 11. Since enactment, approximately 125-150 subchapter V cases per month have been filed across the country, even as total chapter 11 business filings decreased to 3724 cases in 2021, a historic low.

Numerous novel, challenging, and practically important issues have already arisen under the new statute. Two examples are:

- Cantwell-Cleary Co. v. Clearly Packaging LLC (In re Cleary Packaging LLC), 21-1981 (4th Cir. June 7, 2022) construed section 1192 to limit the scope of discharge available to debtors that confirm subchapter V plan nonconsensually to debts that are dischargeable under section 523. It is unclear why Congress would limit discharge in this way—nowhere else in chapter 11 does the scope of the debtor's discharge turn on whether the plan is confirmed under the cramdown provisions,

and it is unclear why cramdown on one class should affect the scope of the discharge available to creditors in consenting classes. If *Cleary Packaging*'s construction of section 1192 becomes the general rule, the utility of subchapter V for entities with debts that fall within section 523(a) may be severely limited.

- The incidence and strategic value of section 1111(b)(2) elections is significantly heightened under subchapter V since unsecured deficiency claims can no longer block plan confirmation by invoking the absolute priority rule under the new procedure. Expect increased litigation over the proper scope and effects of such elections. *See, e.g., Matter of Topp's Mech., Inc.*, No. 21-40038-TLS, 2021 WL 5496560 (Bankr. D. Neb. Nov 23, 2021); *In re VP Williams Trans, LLC*, No. 20-10521 (MEW), 2020 WL 5806507 (Bankr. S.D.N.Y. Sept. 29, 2020).

B. Third Party Releases.

Limited nonconsensual third-party releases of the debtor's insurers and others holding "derivative" claims based on the debtor's liability have long been statutorily authorized in asbestos cases assuming the debtor's plan complies with the many specific requirements of section 524(g). Beyond the asbestos cases the question of whether the bankruptcy court has subject matter jurisdiction to impose a third-party release on the holder of that claim has long divided the courts with the Second, Third, Fourth and Seventh Circuits permitting nonconsensual third-party releases under various conditions and the Fifth, Ninth and Tenth Circuits prohibiting them.

The third-party release issue is of critical importance in resolving mass-tort cases where typically settlement trusts are funded by third parties in exchange for channeling orders which effectively release them from mass-tort liability. The opioid crisis became a flashpoint for the long unresolved debate over third-party releases. In *Purdue Pharma*, the bankruptcy court following a sharply contested confirmation hearing approved the releases of the Sackler family on the ground that their liability while not technically "derivative" of the debtor was nevertheless based on the same basic factual predicate upon which the debtor's own liability to opioid victims was predicated: Purdue's manufacture and marketing of OxyContin. The United States and several nonconsenting state governments appealed, and the district court reversed finding a lack of statutory authority for nonconsensual third-party releases of non-derivative liabilities. The objecting states and Purdue Pharma then entered into an enhanced settlement with the Sacklers, and the states dropped their Second Circuit appeals, but the United States continued to challenge the nonconsensual third-party release of the Sacklers and prosecute its appeal. The matter has now been fully briefed and argued at the Second Circuit. *See In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021) *appeal pending as* Case No. 22-110 (2d Cir. 2022).

Meanwhile, we are seeing a dramatic expansion of third-party releases well beyond the strictures of 524(g) in other non-asbestos cases such as *Johnson & Johnson* and the *Boy Scouts of America*. Johnson & Johnson, facing significant liability based on claims that its iconic baby powder caused ovarian cancer and lung diseases but unwilling to subject itself to a chapter 11 filing, has sought the protection of a channeling order for itself based on a so-called "Texas two-step" transaction – it underwent a "divisive merger" under Texas corporate law and assigned its mass tort liabilities to an assetless shell subsidiary (LTL Management), which it reincorporated in North Carolina to obtain venue in a Circuit (unlike the Fifth Circuit) where third party releases are permitted, and then immediately filed LTL Management in chapter 11. Following the transfer of this case from North Carolina to New Jersey (where Johnson & Johnson is headquartered), an appeal is now pending in the Third Circuit as to whether this maneuver is subject to dismissal as a bad-faith filing. *In re LTL Management LLC*, Nos. 22-2003 through 2011 (3d Cir. 2022).

In the *Boy Scouts* case, *In re Boy Scouts of America*, 20-10343-LSS (Bankr. D. Del.) the debtors seek to confirm a plan with a $2.5 billion settlement trust principally funded by non-debtor parties to manage 82,209 sexual abuse claims accruing over decades. The beneficiaries of the channeling injunction releasing these liabilities include 251 non-debtor local councils, certain settling insurers, and some 100,000 nondebtor independent "chartered organizations" (churches, schools, community organizations, and government bodies) that sponsored the boy scout troops in which the abuse occurred. The bankruptcy court has filed a 281-page Opinion in respect of confirmation that suggests that it is prepared to issue that channeling injunction subject to certain conditions and modifications to the plan. Dkt. No. 10136 (July 29, 2022) *available at* https://cases.omniagentsolutions.com/documents?clientid=3552&tagid=1153.

Finally, on July 26, 2022, Aearo Technologies, a 3M subsidiary that is a co-defendant with 3M itself in mass-tort litigation arising out of allegedly defective ear plugs sold to the United States Armed Forces, availed itself of chapter 11 relief as a stratagem to manage mass-tort litigation. *In re Aearo Technologies LLC*, Case No. 22-02890 (Bankr. S.D. Ind.). Aearo immediately sought a bankruptcy court injunction staying all ear plug litigation against itself and its parent 3M and indicated that it intended to channel the ear plug liabilities against both entities to a settlement trust.

It seems inevitable that the propriety of the expanding use of chapter 11 in these controversial cases to manage mass-tort liabilities on a global scale as to debtors and nondebtors alike will draw the attention of either Congress or the Supreme Court or both. Legislation prohibiting third-party releases and Texas two-steps has been introduced but is not currently moving. So stay tuned for further developments at the intersection of chapter 11 and mass torts.

C. Venue.

The perennial issue of forum shopping and venue reform remains alive and kicking. In a scathing assessment, Adam Levitin found over half of the large chapter 11 cases in 2020 were heard by just three judges. Adam Levitin, *Judge Shopping in Chapter 11 Bankruptcy*, 2022 Illinois L. Rev. ___; *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3900758.

In apparent response to the controversy over this "judge shopping," the Southern District of New York recently modified its rules for assigning large Chapter 11 cases. SDNY Local Rule 1073-1(f) (Dec. 2021) mandates cases exceeding a $100 million threshold be randomly assigned to a bankruptcy judge sitting at any of the district's three divisions whichever division the case happens to be filed in. Two of the three courthouses, White Plains and Poughkeepsie, have only one bankruptcy judge assigned. The rule could be seen as a response to Purdue Pharma seemingly handpicking its judge by choosing to file in White Plains.

Legislative attempts at venue reform, however, remain stalled in Congress. *See* Bankruptcy Venue Reform Act of 2021, H.R. 4193 and S.2827.

D. US Trustee Fees.

The Supreme Court's sole merits bankruptcy decision this Term, *Siegel v. Fitzgerald*, 142 S. Ct. 1770 (2022) held unanimously that the differential fee structure for access to chapter 11 relief for US Trustee and Bankruptcy Administrator districts violated the uniformity requirement in the Bankruptcy Clause of the United States Constitution. U.S. Const., Art. I, § 8, cl. 4. The case was remanded to determine the appropriate remedy for the constitutional violation, a question on which the Court expressed no opinion.

Chapter 11 debtors that paid the higher fees in US Trustee districts will, of course, seek refunds. The US Trustee, however, has not indicated any willingness to make those refunds in pending cases in bankruptcy courts and the Court of Claims. The Government may seek to cure the disparity in treatment among districts by seeking to recover the higher fees from debtors in Bankruptcy Administrator districts rather than by granting refunds in the US Trustee districts. Either approach, refund or belated assessment, appears to guarantee that confusion and litigation over the fee issue will be with us for some time. The Court was careful to confine its *Siegel* opinion to the narrow question of filing fees, but its decision to strike down the filing fee for lack of uniformity raises the question whether the US Trustee system more generally lacks a constitutional foundation because some districts remain outside the system. It also serves as a warning that other aspects of bankruptcy law that vary from district to district may also be subject to challenge for disuniformity.

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Thank you for your continued use of the ELEVENTH EDITION of BANKRUPTCY. We, of course, continue to monitor case law and legislative developments on an on-going basis and remain committed to keeping you advised of significant further new developments.

As always, we look forward to your comments and suggestions. In the meantime, all best wishes for the coming Academic Year!

Very truly yours,

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