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Re: Bussel, Skeel & Harner, BANKRUPTCY (11th ed.) / 2023 Update

Dear Adopters:

We write to inform you of certain caselaw developments since our 2022 Update to the Eleventh Edition that you may wish to reference in your 2023-24 courses.

A. *Supreme Court*.

The Supreme Court decided three bankruptcy cases in October Term 2022:

- *Bartenwerfer v. Buckley*, 143 S.Ct. 665 (2023)
- *MOAC Mall Holdings LLC v. Transform Holdco LLC*, 143 S.Ct. 927 (2023)
- *Lac du Flambeau Band of Lake Superior Chippewa Indians v. Coughlin*, 2023 U.S. LEXIS 2544 (June 15, 2023)

In *Bartenwerfer*, the Court's unanimous decision resolved a circuit split regarding whether debts arising out of fraud for which the individual debtor is vicariously liable under state law are nondischargeable under section 523(a)(2)(A), regardless of the debtor's lack of personal culpability for the fraud. In the opinion authored by Justice Barrett, the Court found the statutory passive voice meant that the nature of the debt rather than the conduct of the debtor was the lynchpin of the exception to discharge, a reading of the language consistent with its 19th century decision, *Strang v. Bradner*, 114 U.S. 555 (1885), involving a similar exception to discharge in a predecessor bankruptcy statute. In the Court's view, Congress subsequently "embraced" *Strang* in the Bankruptcy Act of 1898 when it recodified the nondischargeability exception for fraud. In a concurring opinion, Justice Sotomayor emphasized that the Court's holding was limited to vicarious liability based on agency or partnership law and not simply the marital relationship between the debtor and her fraud-committing husband.

In *MOAC*, Justice Jackson, writing for a unanimous bench, addressed whether a party that had expressly waived the protections of section 363(m) in the bankruptcy court could nevertheless raise statutory mootness under section 363(m) after suffering an adverse ruling on appeal in the district court. The question framed on *certiorari* was whether the statute embodied a nonwaivable jurisdictional principle or a waivable limitation on the scope of appellate remedies. Consistent with the statutory language and the general trend in the Court's cases to narrow the scope of nonwaivable jurisdictional defenses, the

Court found the 363(m) defense nonjurisdictional and therefore waiveable. The decision is expected to have only a very limited impact on practice under section 363 as waivers of 363(m) protections are uncommon and the buyer protections embodied in 363(m) remain generally enforceable limitations on appellate relief.

Finally in *Lac du Flambeau Band v. Coughlin*, again through Justice Jackson, the Court, 8-1, found that the expansive language in section 106(a) waiving the sovereign immunity of all governmental units foreign and domestic in bankruptcy proceedings met the clear statement requirement necessary to effectuate a Congressional waiver of Indian sovereign immunity. As Indian tribes have expanded their operations to include extending various forms of consumer credit (sometimes through so-called "Rent-A-Tribe" schemes, *see* Nathalie Martin, *Brewing Disharmony: Addressing Tribal Sovereign Immunity Claims in Bankruptcy*, 96 Am. Bankr. L.J. 145 (2022)), the ability of bankruptcy courts to subject tribes to the operation of the Bankruptcy Code on the same basis as other governmental units has become essential to the operation of the Code and the protection of the rights of consumer debtors and their other creditors. Accordingly, of the three bankruptcy cases decided this year by the Supreme Court, *Lac du Flambeau* appears to be the most systemically important.

B. *Mass Torts: Third Party Releases, Interim Stays and Bad Faith*.

Mass torts in chapter 11 continues to be an area of tremendous ferment and conflict in the cases. The area cries out for either legislative or Supreme Court intervention to clarify the law.

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). The question of whether the bankruptcy court has the authority to impose a third-party release on nonconsenting creditors beyond the asbestos context has long divided the courts. The Second, Third, Fourth and Seventh Circuits permit nonconsensual third-party releases under various conditions while the Fifth, Ninth and Tenth Circuits prohibit them.

The third-party release issue is of critical importance in resolving mass-tort cases where settlement trusts are typically 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 *In re Purdue Pharma L.P.*, the bankruptcy court, 633 B.R. 53 (Bankr. S.D.N.Y. 2021), 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 facts 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 States appealed, and the district court reversed, 635 B.R. 26 (S.D.N.Y. 2021), 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.

In a much-anticipated ruling released more than a year after oral argument, a divided Second Circuit reversed the district court and reinstated the confirmation order containing the Sackler releases. *In re Purdue Pharma L.P.*, 69 F.4th 45 (2d Cir. 2023). The majority relied on Second Circuit precedent in such cases as *Metromedia*, 416 F.3d 136 (2d Cir. 2005), *Drexel*, 960 F.2d 285 (2d Cir. 1992), and *Johns-Manville,* 837 F.2d 89 (2d Cir.1988), and cited the Supreme Court's decision in *Energy Resources,* 495 U.S. 545, 549 (1990), as authority for a broad reading of the residual provision in section 1123(b)(6) authorizing plan provisions that do not otherwise contravene specific prohibitions of the Bankruptcy Code. It went on to adopt the seven-factor test developed in such cases as *Master Mortgage*, 168 B.R. 930 (Bankr. W.D. Mo.1994), and *Dow Corning*, 280 F.3d 648 (6th Cir. 2002), as the touchstone for approving such releases and upon due consideration of these factors approved the Sackler releases. The persistent split in the circuits on the third-party release issue, and a sharp "concurrence" by Judge Wesley expressing skepticism of the Second Circuit majority's reading of *Energy Resources* and sections 105(a) and 1126(b)(6), suggest that the Second Circuit may not have the final word on this issue.

Meanwhile, we are seeing a dramatic expansion of third-party releases well beyond the strictures of 524(g) in other mass-tort cases involving Johnson & Johnson ("J&J"), 3M, and the Boy Scouts of America.

J&J, 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 J&J is headquartered), the bankruptcy court stayed all pending talc litigation against non-debtor J&J. On appeal, the Third Circuit determined that J&J and its affiliate LTL orchestrated this filing in bad faith as a litigation management device in an absence of financial distress and ordered the case dismissed. *In re LTL Management LLC*, 64 F.4th 84 (3d Cir. 2023). Although the case was thereafter dismissed in accordance with the Third Circuit mandate, LTL refiled for chapter 11 relief in the same court a few weeks later asserting that it had reached a settlement with some portion of its talc creditors. At this time, a renewed motion to dismiss on bad faith grounds by nonsettling talc creditors remains pending in this second case.

In the *Boy Scouts* case, *In re Boy Scouts of America*, 642 B.R. 504 (Bankr. D. Del. 2022), the debtors confirmed a plan with a $2.5 billion settlement trust principally funded by non-debtor parties to manage the 82,209 sexual abuse claims that had accrued over decades at the time of filing. 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's 281-page opinion was affirmed in its entirety by the district court. *In re Boy Scouts of Am.*, 650 B.R. 87 (D. Del. 2023), *appeal docketed*, No. 23-1780 (3d Cir. May 1, 2023). The case is now on appeal in the Third Circuit. A stay pending appeal has been denied and the plan has now gone effective.

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 Techs. LLC*, 642 B.R. 891 (Bankr. S.D. Ind. 2022). 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. That stay was denied, and a subsequent motion to dismiss on bad faith grounds was granted by the bankruptcy court on the basis that the case served no valid reorganization purpose. *In re Aearo Techs. LLC*, No. 22-02890-JJG-11, 2023 WL 3938436 (Bankr. S.D. Ind. Jun. 9, 2023).

The Seventh Circuit accepted direct appeal of the denial of the interim stay in *Aearo* and the appeal remains pending at this writing. *In re Aearo Techs. LLC*, No. 22-2606 (7th Cir. filed Sep. 13, 2022). The intervening dismissal of the case (which itself will no doubt become the subject of an appeal), however, potentially moots that appeal. Even more recently in *Bestwall* (an early Texas two-step case), a divided Fourth Circuit (over Judge King's strong dissent) affirmed an interim injunction staying asbestos claims against the debtor's non-filed parent, Georgia Pacific, and related nonfiled entities pending the debtor's confirmation of a plan channeling mass-asbestos liabilities. *In re Bestwall LLC*, No. 22-1127, 2023 WL 4066848 (4th Cir. June 20, 2023).

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. Cryptocurrency.

Although the rationale and distributed blockchain technology undergirding cryptocurrencies suggested a general disintermediation and radical decentralization of the crypto marketplace, intermediaries did emerge in this market and undertook the functions of exchanges, brokers, securities issuers, depositaries, custodians, hedge funds, and lenders. Regulation was at best uncoordinated and embryonic in this emerging financial market. Since July 2022, we have seen a collapse of the value of cryptocurrencies and spate of bankruptcy filings of major intermediaries including such prominent firms as *Three Arrows Capital, Voyager Digital, Celsius Network, FTX, BlockFi, Core Scientific* and *Genesis Global Capital*. The aggregate losses in these cases is measured in the tens of billions of dollars.

It remains to be seen whether failed crypto intermediaries can be successfully reorganized, whether the crypto markets themselves can be properly managed and regulated, and how the complex and novel issues relating to treatment of claims and assets based in cryptocurrencies will be resolved. To date, the most significant case decision to emerge from the crypto-apocalypse of 2022-23 is Judge Glenn's decision in *Celsius Networks.* Based on a close reading of Celsius's contractual obligations for the 600,000 customers holding "Earn Accounts" with an aggregate value of $4.2 billion, he determined that the cryptocurrencies under Celsius's control in those accounts constituted property of its bankruptcy estate rather than the property of the account holder who had transferred the asset to Celsius for safekeeping or trading purposes. *In re Celsius Network LLC*, 647 B.R. 631 (Bankr. S.D.N.Y. 2023). This decision likely came as a shock to many of the 600,000 account holders who assumed that the crypto assets they deposited in their Celsius accounts would remain their property rather than be shared pro rata among all general unsecured creditors.

Although somewhat tangential to the subject matter of a law school bankruptcy class, the December 13, 2022 congressional testimony of Chief Restructuring Officer John J. Ray discussing the staggering management and governance failures at FTX is an eye-opening look inside the nascent cryptocurrency intermediary industry and related regulatory failures. It can be found at https://democrats-financialservices.house.gov/uploadedfiles/hhrg-117-ba00-wstate-rayj-20221213.pdf.

D. *Ultra Petroleum* and Make-Wholes.

The ELEVENTH EDITION at pp. 674-681, including the reprint of the Fifth Circuit's 2019 decision in *Ultra Petroleum*, has been superseded by a later decision from the same Court in the same case. On October 14, 2022, the Fifth Circuit ruled that the make-whole premium in Ultra Petroleum's master notes purchase agreement (MNPA) was disallowed as the economic equivalent of unmatured interest under Bankruptcy Code § 502(b)(2). *Ultra Petroleum* is the first decision by a circuit court determining that a make-whole premium constitutes unmatured interest and departs from several prior lower-court decisions. The Fifth Circuit also determined that the make-whole premium in the MNPA was nevertheless payable under the "solvent-debtor exception" to the general rule disallowing claims for unmatured interest because the debtor had become solvent by the time the plan had been confirmed. The court additionally found that solvent-debtor post-petition interest should be paid at the contract default rate rather than the federal judgment rate, aligning the Fifth Circuit with the Ninth Circuit's recent decision in *In re PG&E Corp*.

If you choose to cover this material in your course, we recommend that you assign *In re Ultra Petroleum Corp.*, 51 F.4th 138 (5th Cir. 2022) in lieu of ELEVENTH EDITION pp. 674-681.

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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 ongoing 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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