WITHOUT EXCEPTION? THE NINTH CIRCUIT'S EVOLVING STANCE ON NONDEBTOR RELEASES IN CHAPTER 11 REORGANIZATIONS

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INTRODUCTION

Chapter 11 of the Bankruptcy Code (or the "Code") allows a troubled business debtor the opportunity to restructure its financial affairs so that it may successfully operate in the future.[1] To facilitate this process, a Chapter 11 debtor is given the exclusive right to propose a reorganization plan that, among other things, "provides for distribution on, and discharge of, all of the debtor's prebankruptcy debts."[2] Under some circumstances, a Chapter 11 debtor may choose to include a nondebtor release provision in its reorganization plan with creditors. Nondebtor releases (or "third-party releases") vary in scope and form but generally are designed to shield nondebtors from liability on pre- and/or post-petition claims and are accompanied by injunctions barring actions against the released party.[3] Nondebtor releases are often provided in exchange for contributions to the reorganization.[4] For example, guarantors of the debtor may distribute funds to the reorganization effort in exchange for a release from their obligation under the guaranty. If a bankruptcy judge were to approve the nondebtor release and issue an accompanying injunction, any claims a creditor might have had against the guarantor are effectively extinguished.

So long as the enjoined party consents to the release, courts typically have no difficulty in finding the nondebtor release valid.[5] But when bankruptcy courts are asked to approve the release over the objection of an enjoined party, courts are confronted with fundamental questions about the objectives of the Bankruptcy Code and the rights of the enjoined party. How

1. United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983).

2. Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 961 (1997).

3. 4 COLLIER ON BANKRUPTCY ¶ 524.05 (Richard Levin & Henry J. Sommer eds., 16th ed. 2021), LexisNexis; Brubaker, *supra* note 2, at 961; Richard L. Epling, *Third-Party Releases in Bankruptcy Cases: Should There Be Statutory Reform?*, 75 BUS. LAW. 1747, 1749 (2020).

4. *See, e.g.*, *In re* AOV Indus., Inc., 792 F.2d 1140, 1152 (D.C. Cir. 1986) (describing a nondebtor release given in exchange for the nondebtor's commitment of "millions of dollars to a reorganization plan").

5. Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate over Non-Debtor Releases in Chapter 11 Reorganizations*, 23 EMORY BANKR. DEVS. J. 13, 25–26 (2006).

courts decide these issues can have significant consequences for the parties to the bankruptcy case and society more generally.

Does a bankruptcy court have the authority to extinguish otherwise valid claims against a nondebtor to protect the debtor's reorganization effort? And if so, under what conditions? These questions have divided circuit courts for more than three decades.[6] Practically every jurisdiction weighing in on the merits of nondebtor releases has established its own rules regarding their approval or prohibition. A majority of circuit courts hold that nondebtor releases are an appropriate use of the bankruptcy court's equitable powers.[7] They differ, however, on what circumstances justify the inclusion of a nondebtor release in a reorganization plan. Some majority opinions focus on how necessary the release is to ensure the success of the reorganization and thereby avoid liquidation of the debtor's assets.[8] Other courts in the majority balance considerations of necessity with concerns about fairness to enjoined creditors.[9] A minority of jurisdictions prohibit the use of nondebtor releases in reorganization plans under any circumstances.[10] According to these courts, nondebtor releases "improperly insulate" nondebtors and function as de facto discharges outside of bankruptcy.[11]

Until 2020, the Ninth Circuit had "repeatedly held, without exception," that nondebtor releases were precluded by the provisions of the Code.[12] Its decisions denying nondebtor releases used broad language that seemed to foreclose the possibility of the Ninth Circuit approving any nondebtor release, regardless of form or scope.[13] The Ninth Circuit was one of the first appellate courts to disapprove of a nondebtor release under the Bankruptcy Code of 1978,[14] and its opinions laid out a blueprint for other courts in their

6. The Ninth Circuit denied a nondebtor release as early as 1985 in *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985). One year later, the D.C. Circuit approved a nondebtor release in *In re AOV Indus., Inc.*, 792 F.2d at 1154.

7. SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (*In re* Seaside Eng'g & Surveying, Inc.), 780 F.3d 1070, 1077–78 (11th Cir. 2015) (describing the circuit split); *see infra* Table 1 (describing competing interpretations among different circuits).

8. *See, e.g.*, *In re* Drexel Burnham Lambert Grp., Inc., 960 F.2d 285, 293 (2d Cir. 1992) (holding "a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan").

9. *See, e.g.*, Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 211–14 (3d Cir. 2000); *see also infra* Table 1.

10. *In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d at 1077–78; *see infra* Table 1.

11. *See, e.g.*, *In re* W. Real Est. Fund, Inc., 922 F.2d 592, 602, 600 (10th Cir. 1990) ("Obviously, it is the debtor, who has invoked and submitted to the bankruptcy process, that is entitled to its protections; Congress did not intend to extend such benefits to third-party bystanders.").

12. Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1401 (9th Cir. 1995).

13. *See id.* at 1401–02; *see also* Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 626 (9th Cir. 1989) (concluding § 524(e) "limits the court's equitable power under section 105 to order the discharge of the liabilities of nondebtors").

14. *See supra* note 6.

disapproval of nondebtor releases.[15] To say the Ninth Circuit was firmly established in the minority of jurisdictions prohibiting nondebtor releases is a bit of an understatement. In many ways, it was the leading authority on the invalidity of nondebtor releases.[16]

The Ninth Circuit's decision in *Blixseth v. Credit Suisse* revised its stance on nondebtor releases. *Blixseth* involved a type of nondebtor release known as an exculpation clause.[17] Exculpation clauses are designed to release any named party, including nondebtors, from liability for any negligent acts or omissions related to the formulation, negotiation, or confirmation of the Chapter 11 case itself.[18] Seemingly upending decades of precedent, *Blixseth* held the language of the Bankruptcy Code did not prohibit such a "narrow" nondebtor release.[19] Contrasting the "sweeping nondebtor releases" denied in previous Ninth Circuit decisions, the court opined that the exculpation clause in *Blixseth* did "nothing more than allow the settling parties . . . to engage in the give-and-take of the bankruptcy proceeding without fear of subsequent litigation over any potentially negligent actions in those proceedings."[20] After decades of disapproving of nondebtor releases, *Blixseth*'s reasoning and statutory interpretation indicate an important, yet incremental, shift towards the majority view on nondebtor releases.

This Note will conduct a critical analysis of *Blixseth* to illuminate how the decision differs from the court's previous decisions on nondebtor releases and what it means for the future of nondebtor releases in the Ninth Circuit. The Note will then draw from that analysis to critique *Blixseth*'s reasoning and point to an alternative position on nondebtor releases that better aligns with the provisions and goals of the Bankruptcy Code. Part I will discuss the policy goals of Chapter 11 of the Bankruptcy Code and their relationship to nondebtor releases, analyze the statutory provisions relevant to the debate on nondebtor releases, and review the most common forms of nondebtor releases. Part II contains an analysis of the court's reasoning in *Blixseth* and its predecessors and attempts to forecast how the court will rule on nondebtor releases in the future. Finally, Part III will argue that the Ninth

15. *See In re* W. Real Est. Fund, Inc., 922 F.2d at 601–02 ("[W]e follow the Ninth Circuit's lead . . . and hold that . . . the stay may not be extended post-confirmation in the form of a permanent injunction that effectively relieves the nondebtor from its own liability to the creditor.").

16. Silverstein, *supra* note 5, at 44 (noting "[t]he Ninth Circuit is the leading proponent of the view that third-party releases are invalid under § 524(e)").

17. Blixseth v. Credit Suisse, 961 F.3d 1074, 1078–79 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021).

18. Joshua M. Silverstein, *Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies*, 78 UMKC L. REV. 1, 30 (2009).

19. *Blixseth*, 961 F.3d at 1082.

20. *Id.* at 1083–84.

Circuit should have embraced a more liberal position on nondebtor releases because the Code does not prohibit nondebtor releases and it sufficiently mitigates the "potential for abuse"[21] posed by nondebtor releases.

I. ANALYTICAL FRAMEWORK

In order to provide a framework for analyzing the Ninth Circuit's opinions on nondebtor releases in Part II, Part I will describe the policy considerations, statutory provisions, and forms of nondebtor releases relevant to the discussion. Additionally, it is important to establish the scope of this Note. The primary issues discussed here relate to the circumstances under which bankruptcy courts appropriately exercise their authority to approve nondebtor releases. Whether bankruptcy courts have the jurisdiction to rule on nondebtor releases—a related but separate issue—is beyond the scope of this Note.[22] Additionally, this Note is concerned with *nonconsensual* nondebtor releases in which a bankruptcy court approves the release over the objection of some other party. Consensual nondebtor releases are, in large measure, a question of contract law and have no bearing on the issues central to this Note.[23] Another issue outside the scope of this

21. Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 142 (2d Cir. 2005) ("The potential for abuse is heightened when [nondebtor] releases afford blanket immunity.").

22. Jurisdiction is "[p]erhaps the most complicated and confusing aspect of the controversy surrounding non-debtor releases and injunctions." Brubaker, *supra* note 2, at 1033. Until 2011, courts were more easily able to exercise jurisdiction to rule on nondebtor releases under the Supreme Court's holding in *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995). *Celotex* held that 28 U.S.C § 1334(b), which grants district courts' jurisdiction of all proceedings "related to" the Bankruptcy Code, must be read to give bankruptcy courts "jurisdiction over more than simple proceedings involving the property of the debtor or the estate." *Id.* In 2011, the Supreme Court considerably narrowed bankruptcy courts' jurisdiction in *Stern v. Marshall*, 564 U.S. 462, 487, 499 (2011), holding that a bankruptcy court may exceed its jurisdiction when it rules on a traditionally state common law claim that might be unaffected by the adjudication of the creditor's claim in bankruptcy. "[T]he question is," according to the Supreme Court, "whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Id.* at 499. Few appellate courts have applied *Stern's* holding in the context of nondebtor releases, but the trend seems to be that bankruptcy courts will continue to enjoy jurisdiction to rule on their validity, as nondebtor releases often stem from the bankruptcy itself. The Third Circuit conducted perhaps the most thorough discussion on the issue post-*Stern* in *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 135–36 (3d Cir. 2019), *cert. denied*, 140 S. Ct. 2805 (2020), ultimately interpreting *Stern* to hold that the bankruptcy court's exercise of jurisdiction is permissible "if it involves a matter integral to the restructuring of the debtor-creditor relationship." *Id.* at 137.

Others argue that a bankruptcy court oversteps its jurisdiction in ruling on nondebtor releases. Ralph Brubaker, *Nondebtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten* Callaway v. Benton *Case*, 72 AM. BANKR. L.J. 1, 7 (1998); Judith R. Starr, *Bankruptcy Court Jurisdiction to Release Insiders from Creditor Claims in Corporate Reorganizations*, 9 BANKR. DEVS. J. 485, 487–93 (1993). Professor Ralph Brubaker argues that this approach "abuses the historical distinction between jurisdiction to enjoin and jurisdiction to adjudicate, and it improperly assumes that facilitation of the debtor's reorganization effort is an independent basis on which to adjudicate a non-debtor action" in contravention of binding precedent established by the Supreme Court in *Callaway v. Benton*. Brubaker, *supra* note 2, at 1069.

23. Silverstein, *supra* note 5, at 25.

Note is the use of nondebtor releases in asbestos-related bankruptcies. Congress specifically sanctioned the use of nondebtor releases in that context through § 524(g) of the Code but has made no rules regarding the validity of nondebtor releases in other contexts.[24] Finally, the issues discussed in this Note primarily implicate *permanent* injunctions shielding nondebtors from liability, not temporary injunctions, which are commonly used by bankruptcy courts to efficiently conduct the bankruptcy proceedings.[25]

A. POLICY OBJECTIVES OF CHAPTER 11 OF THE BANKRUPTCY CODE

Insolvent business debtors have two general remedies in bankruptcy: liquidation under Chapter 7 or reorganization under Chapter 11.[26] In a liquidation, the business's assets are "sold for scrap"[27] and the proceeds are distributed to creditors according to established priorities.[28] Chapter 11 reorganizations, on the other hand, are designed to allow the business to maintain possession of its assets, continue operations, and pay creditors from future revenue.[29] If the present value of the business's future earning power, which is known as its "going concern" value, is greater than the liquidation value of its assets, a Chapter 11 reorganization will probably be the more favorable option for the business as it will be able to realize that value instead of lose it in liquidation.[30] Creditors and equity security holders may benefit from reorganization as well, as the reorganized business will, in theory, generate more funds for distribution than liquidation would.[31] Finally, society may benefit from reorganization, as continued operation "can save the jobs of employees and the tax base of communities, and generally reduce

24. Section 524(g) permits bankruptcy courts to issue channeling injunctions redirecting claims against a nondebtor to a trust established to satisfy "actions seeking recovery for damages allegedly caused by the presence of, or exposure to, asbestos or asbestos-containing products." 11 U.S.C. § 524(g)(1)(A)–(2)(B). When Congress amended § 524 in 1994 to include subsection (g), it included a rule of construction stating that nothing in subsection (g) "shall be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization." Bankruptcy Reform Act of 1994, Pub. L. 103-394, § 111(b), 108 Stat. 4106, 4117. As such, this Note assumes the addition of subsection (g) to § 524 has no bearing on the validity of nondebtor releases outside of the asbestos context. *See generally* Silverstein, *supra* note 5, at 50 n.204 (summarizing different views of § 524(g)'s effect on the validity of nondebtor releases outside of the asbestos context).

25. Brubaker, *supra* note 2, at 968 (noting temporary nondebtor stays are "widely accepted as a legitimate exercise of a bankruptcy court's equitable powers").

26. DANIEL J. BUSSEL & DAVID A. SKEEL, JR., BANKRUPTCY 523 (Robert C. Clark et al. eds., 10th ed. 2015).

27. United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983).

28. *See* 11 U.S.C. § 726 (detailing the priorities for distribution of the property of bankruptcy estates).

29. *See Whiting Pools, Inc.*, 462 U.S. at 203 (noting Chapter 11 authorizes the debtor-in-possession or trustee "to manage the property of the estate and to continue the operation of the business").

30. BUSSEL & SKEEL, *supra* note 26, at 523.

31. *Id*.

the upheaval that can result from termination of a business."[32] With these considerations in mind, the Supreme Court described the underlying policies of Chapter 11 reorganizations as "preserving going concerns and maximizing property available to satisfy creditors."[33]

Majority view courts often emphasize these policies in approving nondebtor releases. Nondebtor releases can play a crucial role in a debtor's reorganization if given in exchange for substantial contributions to the reorganization effort. In such circumstances, majority courts may conclude that without the nondebtor release at issue, the debtor's reorganization would not be feasible.[34] In other circumstances, the nondebtor release may be used as a defensive measure to protect the reorganization effort. In *Menard-Sanford v. Mabey*, the Fourth Circuit approved a nondebtor release in which the success of the reorganization "hinge[d]" on the debtor being free from "indirect claims such as suits against parties who would have indemnity or contribution claims against the debtor."[35] The court found that without the nondebtor release, the debtor would have faced multiple fronts of attack from creditors on one side and nondebtors with indemnity or contribution claims on the other.[36] Such liabilities could have resulted in plan failure and possibly liquidation.[37] In the aforementioned situations, nondebtor releases arguably advance the objectives of preserving going concern value and maximizing creditor recovery by increasing the likelihood of a successful reorganization. By extinguishing some claims, nondebtor releases may save the debtor from liquidation, thereby creating the opportunity for a bigger pot from which all parties may draw.[38]

Courts in the minority question whether nondebtor releases actually advance the policies of Chapter 11. For example, in *In re Western Real Estate Fund*, the Tenth Circuit argued that approving nondebtor releases to protect debtors from indemnification liability extinguishes creditor claims "without any countervailing justification of debtor protection."[39] The Code already shields debtors from indemnification liability during and after

32. 7 COLLIER ON BANKRUPTCY ¶ 1100.01 (Richard Levin & Henry J. Sommer eds., 16th ed. 2021), LexisNexis.

33. Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999).

34. *See, e.g.*, Airadigm Commc'ns, Inc. v. FCC (*In re* Airadigm Commc'ns, Inc.), 519 F.3d 640, 657 (7th Cir. 2008).

35. Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989).

36. *Id.*

37. *See id.*

38. *See In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 685 (Bankr. D.D.C. 1992) (concluding "the estate's property interest in recovering from partners for the benefit of creditors . . . constitutes a common pool for the benefit of creditors and injunctive relief to assure the maximization of that pool may be warranted").

39. *In re* W. Real Est. Fund, Inc., 922 F.2d 592, 602 (10th Cir. 1990).

reorganization, the Tenth Circuit argued.[40] The automatic stay protects debtors from indemnification claims during bankruptcy proceedings and under § 1141(d)(1)(A),[41] plan confirmation discharges the debtor from any debt "that arose before" confirmation.[42] Indemnification claims generally arise before confirmation and are therefore subject to discharge under § 1141(d)(1)(A).[43] Thus, the Tenth Circuit found that the Fourth Circuit's worry in *Menard-Sanford* that indemnification claims could impede restructuring was unwarranted.[44] Similarly, the Fifth Circuit has doubted whether the costs of defending against a negligence suit for acts related to the Chapter 11 case are significant enough to justify the use of an exculpation clause releasing nondebtors from such liability.[45] The court found "little equitable" about protecting nondebtors when future negligence suits "are unlikely to swamp either these parties or the consummated reorganization."[46]

Even if a nondebtor release advances the objectives of the Code, majority courts may nevertheless disapprove of the release if fairness concerns outweigh the necessity of the release. Many majority courts are wary of the "potential for abuse"[47] in nondebtor releases.[48] Peter Boyle notes approval of nondebtor releases could impair the "integrity of guaranties" and negatively impact the cost of financing, decrease "the probability that victims of joint tortfeasors will receive full compensation," and create a "sanctuary for culpable officers and directors of corporations."[49] Many majority courts conclude that enjoining valid claims, which may only be tangentially related to the bankruptcy, to protect a debtor's reorganization is a radical power that should be used only in "truly unusual circumstances."[50] The Sixth Circuit, for example, has established a formal list of factors, which

40. *Id.* at 600.

41. 11 U.S.C. § 1141(d)(1)(A).

42. *In re W. Real Est. Fund, Inc.*, 922 F.2d at 600–02.

43. *Id.*; *see also* Peter M. Boyle, *Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy*, 61 FORDHAM L. REV. 421, 440–41, 441–42 n.117 (1992) (noting that while some courts may not view indemnification as pre-petition debt, "[c]ourts that view claims for indemnification as pre-petition claims are on 'surer footing' with Congressional intent").

44. *In re W. Real Est. Fund, Inc.*, 922 F.2d at 600–02.

45. *See* Bank of N.Y. Tr. Co. v. Off. Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 252 (5th Cir. 2009).

46. *Id.*

47. Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 142 (2d Cir. 2005).

48. *See* Behrmann v. Nat'l Heritage Found., Inc., 663 F.3d 704, 712 (4th Cir. 2011) (concluding that approval of nondebtor releases "should be granted cautiously and infrequently" and noting similar language used by the Second, Sixth, and Third Circuits).

49. Boyle, *supra* note 43, at 422; *see also* Starr, *supra* note 22, at 499 (noting nondebtor releases may create a moral hazard in which "insiders may be tempted to engage in high risk behavior by the knowledge that they can protect themselves from its consequences by taking the corporation into chapter 11").

50. *See, e.g.*, *In re Metromedia Fiber Network, Inc.*, 416 F.3d at 143.

incorporate considerations of fairness to creditors and necessity to the reorganization, that must be present to justify the use of a nondebtor release.[51] The Third Circuit has chosen a more flexible approach that requires bankruptcy courts to weigh only the fairness and necessity of the release. In *Gillman v. Continental Airlines*, the Third Circuit denied a nondebtor release that barred securities fraud claims against the debtor's directors and officers.[52] In reversing the lower courts' approval of the plan, the Third Circuit said that nothing in the record implied that the reorganization's success bore any relationship to the release and that there was a similar dearth of findings on the fairness of the release to the enjoined creditors.[53]

Generally, the more concerned a court is about the fairness of nondebtor releases to the enjoined party, the less likely it is to approve nondebtor releases. Conversely, the more value a court places on reorganization, the more likely it is to approve nondebtor releases. Between the two points on this spectrum, courts conduct detailed, case-by-case balancing tests to determine whether the necessity of the release to the reorganization outweighs any unfairness to enjoined creditors.

B. STATUTES RELEVANT TO THE VALIDITY OF NONDEBTOR RELEASES

There are two primary sections of the Bankruptcy Code implicated by nondebtor releases: §§ 524(e) and 105(a). Section 524(e) is arguably the most important statute for nondebtor releases, as courts' interpretation of the statute determines the preliminary issue of whether the Code prohibits nondebtor releases. Only after this determination has been made can courts evaluate whether the scope of the release is permissible. This secondary level of consideration implicates the courts' equitable powers under § 105(a).

1. Section 524(e)

Section 524(e) provides that the "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."[54] In other words, the debtor's discharge does not, by its own force, affect the liability of third parties on the discharged debt. This reinforces the general principle in bankruptcy that discharge does not eliminate the debt, just a debtor's liability on the debt.[55] Co-debtors, such as

51. *See* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002).
52. Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 211, 217 (3d Cir. 2000).
53. *Id.* at 214–17.
54. 11 U.S.C § 524(e).
55. *See, e.g.*, Johnson v. Home State Bank, 501 U.S. 78, 83 (1991) (noting "discharge extinguishes

guarantors, are not automatically released by a debtor's discharge under the plain language of the statute. This principle has been embodied in every prior version of the Bankruptcy Code.[56] Section 16 of the Bankruptcy Act of 1898 provided "liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt."[57] Notably, § 16 of the Act says that the liability of a co-debtor or guarantor "shall" not be affected by the debtor's discharge,[58] whereas § 524(e) merely states that discharge "does not" affect third-party liability for "such debt."[59] The shift from the mandatory language of § 16 of the Act to the descriptive language of § 524(e) of the Code plays a crucial role in many appellate opinions dealing with nondebtor releases.

The circuits disagree about the reach of § 524(e).[60] Jurisdictions in the minority advance what will be referred to in this Note as a "broad" reading of § 524(e). Under a broad reading, a release that would insulate *any* third party from liability on *any* claim is impermissible.[61] Nondebtor releases, they argue, "affect the liability" of a third party by eliminating the liability altogether.[62] Thus, nondebtor releases directly conflict with § 524(e) and are invalid. These courts tend to argue that the purpose of the discharge is to give a fresh start to the debtors, who have submitted themselves to the bankruptcy process.[63] Nondebtor releases, they argue, essentially discharge the indebtedness of a party that has not petitioned for bankruptcy.[64] For example, the Fifth Circuit in *In re Pacific Lumber Co.* invalidated an exculpation clause, holding § 524(e) "only releases the debtor, not co-liable third parties" and that the "fresh start § 524(e) provides to debtors is not intended to" absolve parties from negligent conduct during the course of the bankruptcy.[65]

On the other hand, courts in the majority adopt a less restrictive view of § 524(e), ultimately concluding that the statute does not function as a per se prohibition against any nondebtor release. While the majority view jurisdictions agree that § 524(e) is not a per se prohibition on nondebtor

only 'the personal liability of the debtor' ").

56. *See* Brubaker, *supra* note 2, at 972 n.46.

57. Act of July 1, 1898, ch. 541, § 16, 30 Stat. 550 (repealed 1978).

58. *Id.*

59. 11 U.S.C § 524(e).

60. *See infra* Table 1.

61. *See, e.g.*, Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) (concluding that § 524(e) "prohibits the discharge of debts of nondebtors").

62. *See, e.g.*, *In re* W. Real Est. Fund, Inc., 922 F.2d 592, 600 (10th Cir. 1990).

63. *E.g.*, *id.* ("Obviously, it is the debtor, who has invoked and submitted to the bankruptcy process, that is entitled to its protections; Congress did not intend to extend such benefits to third-party bystanders.").

64. *Id.*; *In re Zale Corp.*, 62 F.3d at 760.

65. Bank of N.Y. Tr. Co., NA v. Off. Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 252–53 (5th Cir. 2009).

releases, they adopt three competing interpretations of § 524(e)'s reach. First, the "strong narrow" view holds nondebtor releases are unenforceable if they "affect the liability" of a third party on the discharged debt.[66] Thus, under the strong narrow view, some nondebtor releases simply fall outside the scope of § 524(e). This is the view adopted by the Ninth Circuit in *Blixseth*.[67] The exculpation clause there only affected third party liability on claims independent of the debt, and thus did not implicate § 524(e).[68]

Second, the "weak narrow" view argues that a bankruptcy court's equitable powers may allow it to create an exception to § 524(e) under certain circumstances, such as when a creditor's claim against a third party is channeled to a fund for payment.[69] The Fourth Circuit adopted this view of the statute in *Menard-Sanford v. Mabey*.[70] The court said § 524(e) need not be "literally applied in every case as a prohibition on the power of the bankruptcy courts" when three factors are present: overwhelming claimant approval of the plan, the injunction is essential to the reorganization, and the claimants affected by the injunction have another means of recovery.[71] But when none of the factors are present, the release would likely be invalid.[72]

Finally, the "negative" view of § 524(e) argues that § 524(e) actually has no bearing on nondebtor releases whatsoever, as there is no affirmative prohibition to be found in the section.[73] A "natural reading" of the provision "does not foreclose a third-party release from a creditor's claims," according to courts in these jurisdictions.[74] The Seventh Circuit, arguably the circuit court most receptive to nondebtor releases, embraced this view in *In re Airadigm Communications*.[75] There, the court concluded § 524(e) is a

66. *See, e.g.*, *In re* PWS Holding Corp., 228 F.3d 224, 245–46, 247 (3d Cir. 2000) (holding "because this release does not affect the liability of third parties, but rather sets forth the appropriate standard of liability, we believe that this release is outside the scope of § 524(e)").

67. *See* Blixseth v. Credit Suisse, 961 F.3d 1074, 1082, 1084 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021).

68. *Id.* at 1082–83.

69. *See* Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 701–02 (4th Cir. 1989) (holding § 524(e) may not limit the equitable power of the bankruptcy court to issue nondebtor releases when three factors are present); Starr, *supra* note 22, at 492 ("*Menard-Sanford* . . . applied a *judicially-created exception* to section 524(e) for cases where the discharge of a nondebtor is needed to facilitate a plan of reorganization" (emphasis added)).

70. *In re A.H. Robins Co.*, 880 F.2d at 702.

71. *See id.*

72. *See id.*

73. *See, e.g.*, *In re* Specialty Equip. Cos., 3 F.3d 1043, 1046–47 (7th Cir. 1993) (concluding "the statute does not by its specific words preclude all releases that are accepted and confirmed as an integral part of a reorganization").

74. Airadigm Commc'ns, Inc. v. FCC (*In re* Airadigm Commc'ns., Inc.), 519 F.3d 640, 656 (7th Cir. 2008).

75. *Id.* ("In any event, § 524(e) does not purport to limit the bankruptcy court's powers to release a non-debtor from a creditor's claims.").

"savings clause" that "limits the operation of other parts of the Code and preserves rights that might otherwise be construed as lost after the reorganization."[76] Specifically, § 524(e) limits the operation of § 524(a)(2), which enjoins actions to collect the discharged debt. Section 524(e) limits the protection of the discharge to the debtor, meaning creditors maintain their right to seek recovery from co-debtors not in bankruptcy proceedings. Had Congress wanted the section to function as an affirmative prohibition, it would have rephrased the section to hold that discharge "shall" or "will" not affect the liability of third parties to the discharged debt—not that discharge "does" not affect such liability.[77]

TABLE 1. Competing Interpretations of § 524(e)

Interpretation	*Definition*	*Adopting Circuit Courts*
Broad	Section 524(e) prohibits all nondebtor releases.	• Fifth[78] • Tenth[79] • Pre-*Blixseth* Ninth[80]
Strong Narrow	Section 524(e) prohibits only nondebtor releases that affect a third party's liability on the discharged debt.	• Third[81] • Post-*Blixseth* Ninth[82]
Weak Narrow	Exceptions to § 524(e)'s prohibition on nondebtor releases may be made under certain circumstances.	• Fourth[83]
Negative	Section 524(e) contains no affirmative prohibition on nondebtor releases.	• Sixth[84] • Seventh[85] • Eleventh[86]

76. *Id.*

77. *Id.*

78. Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) ("Section 524 prohibits the discharge of debts of nondebtors.").

79. *In re* W. Real Est. Fund, Inc., 922 F.2d 592, 600–02 (10th Cir. 1990) (holding nondebtor releases "improperly insulate nondebtors in violation of section 524(e) . . . without any countervailing justification of debtor protection").

80. Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1401 (9th Cir. 1995) ("[Section] 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors.").

81. *In re* PWS Holding Corp., 228 F.3d 224, 245–46 (3d Cir. 2000) (concluding § 524(e) "only provides that a discharge of the debtor does not affect the liability of non-debtors on claims by third parties against them for the debt discharged in bankruptcy" and that the nondebtor release at issue did not fall within this definition).

82. *See* discussion *infra* Section II.B.

83. *See* discussion *supra* notes 69–72.

84. Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 657 (6th Cir. 2002) (concluding the section only "explains the effect of a debtor's discharge" and does not "prohibit the release of a non-debtor").

85. *See* discussion *supra* notes 74–75.

86. SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (*In re* Seaside Eng'g & Surveying, Inc.), 780 F.3d 1070, 1078 (11th Cir. 2015) (concluding "§ 524(e) says nothing about the authority of the bankruptcy court to release a non-debtor from a creditor's claims").

2. Section 105(a)

Section 105(a) allows bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code.[87] In the Chapter 11 context, this section pertains to the bankruptcy court's equitable powers to facilitate a debtor's reorganization. But just as there are competing interpretations of § 524(e), courts are also divided on the extent of equitable powers granted to bankruptcy courts by § 105(a). The opposing views on § 105(a)'s grant of equitable powers may be divided into two camps: the "liberal" view and the "restrictive" view.

Courts adopting the restrictive view do not see the section as a grant of substantive power and hold that any exercise of § 105(a) power must be tied to a specific provision of the Bankruptcy Code.[88] Section 105(a) "supplements courts' specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code."[89] Thus, the restrictive view adopts a literal reading of § 105(a)'s grant of equitable powers to carry out the "*provisions*" of the Code.[90] As there is no provision of the Code that authorizes nondebtor releases outside of the asbestos context,[91] a restrictive reading would seem to preclude the application of § 105 in support of nondebtor releases. The Third Circuit in *In re Continental Airlines* advanced a restrictive view of § 105(a), concluding the section merely "supplements courts' specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code."[92] According to the Third Circuit, the section does not "create substantive rights that would otherwise be unavailable under the Bankruptcy Code."[93]

The liberal view, on the other hand, argues that an exercise of § 105(a) power need not be tied to a specific provision of the Code.[94] Bankruptcy courts may wield their § 105(a) powers to achieve the overarching goals of the Code.[95] As previously discussed, in the Chapter 11 context, the primary

87. 11 U.S.C. § 105(a).

88. 2 COLLIER ON BANKRUPTCY ¶ 105.01 (Richard Levin & Henry J. Sommer eds., 16th ed. 2021), LexisNexis.

89. Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 211 (3d Cir. 2000).

90. 2 COLLIER ON BANKRUPTCY, *supra* note 88 (noting that using the word " 'provisions' . . . . suggests that an exercise of section 105 power be tied to another Bankruptcy Code section and not merely to a general bankruptcy concept or objective").

91. *See* discussion *supra* note 22.

92. *In re Cont'l Airlines*, 203 F.3d at 211.

93. *Id.*

94. *See* 2 COLLIER ON BANKRUPTCY, *supra* note 88 (noting a liberal view of § 105(a) views the section as a grant of authority to "fill the gaps left by the statutory language" to achieve the goals of the Bankruptcy Code).

95. *Id.*; *see also In re* Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 934 (Bankr. W.D. Mo. 1994)

goals of the Code are preserving going concern value and maximizing creditor recovery.[96] In many circumstances, reorganization will be the most favorable manner of achieving these goals.[97] Thus, under a liberal view of § 105(a), bankruptcy courts have the authority to issue any order necessary or appropriate to facilitate a Chapter 11 debtor's reorganization, subject to some restraints discussed below.[98]

Most courts in the majority adopt a liberal view of § 105(a). For example, the Sixth Circuit in *In re Dow Corning Corp.* held § 105(a) grants bankruptcy courts "substantial power to reorder creditor-debtor relations needed to achieve a successful reorganization."[99] Such powers include the ability to "order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other creditors."[100] According to the Sixth Circuit, bankruptcy courts have similar equitable powers to enjoin creditors from asserting claims against nondebtors to protect the reorganization effort, which the court described as "the bankruptcy court's primary function."[101]

The Supreme Court seems to have endorsed a substantive grant of equitable power to bankruptcy courts. In *United States v. Energy Resources Co.*, the Court said the directive of § 105(a) is "consistent with the traditional understanding that bankruptcy courts, as courts of equity, have *broad authority* to modify creditor-debtor relationships."[102] Such power allows bankruptcy courts to issue orders that may not be "explicitly authorize[d]" by the Bankruptcy Code.[103] Elsewhere, the Supreme Court has held bankruptcy courts are authorized to wield their "broad equitable powers to balance the interests of the affected parties, guided by the overriding goal of ensuring the success of the reorganization."[104] Thus, according to Supreme Court precedent, bankruptcy courts' § 105(a) powers permit them to issue orders necessary and appropriate to the reorganization, even if they are not tethered to a specific provision of the Bankruptcy Code.

(noting § 105 is "broadly written allowing all orders that are necessary and proper to effectuate a reorganization").

96. *See supra* text accompanying notes 26–33.

97. *See supra* text accompanying notes 26–33.

98. *See* discussion *infra* notes 122–42.

99. Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 656 (6th Cir. 2002).

100. *Id.* (citing Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 701 (4th Cir. 1989)).

101. *Id.*

102. United States v. Energy Res. Co., 495 U.S. 545, 549 (1990) (emphasis added).

103. *Id.* at 549–51.

104. Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship, 507 U.S. 380, 389 (1993).

TABLE 2. Competing Interpretations of § 105(a)

Interpretation	*Definition*	*Adopting Circuit Courts*
Restrictive	Any exercise of § 105(a) powers must be tied to a specific *provision* of the Bankruptcy Code. The section is not a substantive grant of equitable power.	• Second[105] • Third[106] • Pre- and Post-*Blixseth* Ninth[107]
Liberal	Bankruptcy courts may exercise their § 105(a) powers to achieve the *goals* of the Bankruptcy Code. Such an exercise of equitable power need not be tied to a specific provision of the Code.	• Fourth[108] • Fifth[109] • Sixth[110] • Seventh[111] • Eleventh[112]

All courts, however, recognize that § 105(a)'s grant of equitable powers is not unlimited. The language of § 105(a) itself offers some hints of its confines. The statute grants bankruptcy courts authority to "carry out the provisions" of the Code.[113] As the Supreme Court observed, "it is quite impossible to do that by taking action that the Code prohibits."[114] Section 1123(b)(6), which many courts read in conjunction with § 105(a) in determining the validity of nondebtor releases, echoes § 105(a)'s self-

105. Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 142 (2d Cir. 2005) (holding any equitable power granted under § 105(a) "must derive ultimately from some other provision of the Bankruptcy Code").

106. *See* discussion *supra* notes 92–02.

107. *See* discussion *infra* Sections II.A–B.

108. Dalkon Shield Claimants Tr. v. Reiser (*In re* A.H. Robins Co.), 972 F.2d 77, 82 (4th Cir. 1992) ("Staying third party litigation is within the broad equity powers granted bankruptcy courts under 11 U.S.C. § 105(a).").

109. Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) (noting the court "liberally" interpreted § 105(a)).

110. Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 656 (6th Cir. 2002) (noting that under §§ 105(a) and 1123(b)(6), bankruptcy courts have "substantial power to reorder creditor-debtor relations needed to achieve a successful reorganization").

111. Airadigm Commc'ns., Inc. v. FCC (*In re* Airadigm Commc'ns., Inc.), 519 F.3d 640, 657 (7th Cir. 2008) (concluding §§ 105(a) and 1123(b)(6) permit bankruptcy courts to "exercise . . . broad equitable powers within the plans of reorganization themselves").

112. Munford v. Munford, Inc. (*In re* Munford, Inc.), 97 F.3d 449, 455 (11th Cir. 1996) (concluding "section 105(a) and [Fed. R. Civ. P.] 16 authorize bankruptcy courts to enter bar orders where such orders are integral to settlement in an adversary proceeding").

113. 11 U.S.C. § 105(a).

114. Law v. Siegel, 571 U.S. 415, 421 (2014).

imposed limitation by permitting a reorganization plan to include any terms "not inconsistent with the applicable provisions" of the Code.[115] Additionally, the Supreme Court said in *Energy Resources Co.* that a bankruptcy court's order "might be inappropriate if it conflicted with another law that should have been taken into consideration in the exercise of the court's discretion."[116] Each of these rules set boundaries for the bankruptcy court's equitable authority. They dictate only where the court cannot go, not where it can. The lack of an affirmative proscription of bankruptcy courts' powers under § 105(a) arguably lends additional credence to courts espousing an expansive view of bankruptcy courts' equitable powers.

C. PRIMARY FORMS OF NONDEBTOR RELEASES

Nondebtor releases come in a variety of forms and may apply to a number of different parties. Generally, they fall into one of three categories: exculpation clauses, channeling injunctions, or actual releases.

1. Exculpation Clauses

Exculpation clauses are arguably the least offensive form of nondebtor release. They are "commonplace provision[s]" included in reorganization plans.[117] Typically, they release the named parties from liability for any acts or omissions related to the negotiation, filing, and confirmation of the bankruptcy plan, and they are often limited to negligence liability.[118] The usual justifications for the inclusion of an exculpation clause in a reorganization plan are to (1) lend finality to the Chapter 11 case by precluding litigation over potentially negligent acts committed during the formulation or confirmation of the reorganization plan,[119] and (2) allow the parties negotiating over the reorganization plan to do so efficiently and without fear of subsequent litigation.[120]

There is at least some debate as to whether exculpation clauses should even be called nondebtor releases.[121] By their nature, exculpation clauses "extinguish causes of action flowing from *post*-petition activities," while

115. 11 U.S.C. § 1123(b)(6).
116. United States v. Energy Res. Co., 495 U.S. 545, 550 (1990).
117. *In re* PWS Holding Corp., 228 F.3d 224, 245 (3d Cir. 2000).
118. Silverstein, *supra* note 18, at 30.
119. *See, e.g.*, *In re* Yellowstone Mountain Club, LLC, 460 B.R. 254, 273–74 (Bankr. D. Mont. 2011) (noting the unsecured creditor committee's representative wanted to include the exculpation clause because "[t]here needs to be that repose, and for me that's the most important thing, 'This is the end of it, we're done' ").
120. *See, e.g.*, Blixseth v. Credit Suisse, 961 F.3d 1074, 1084 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021) (noting exculpation clause was added to reorganization plan to allow settling parties to "engage in the give-and-take of the bankruptcy proceeding without fear of subsequent litigation").
121. *See* Silverstein, *supra* note 18, at 30.

other forms of nondebtor releases are primarily concerned with releasing claims for *pre*-petition conduct.[122] In fact, prior to *Blixseth*, a California bankruptcy court concluded that "where an exculpation clause is limited to post-petition conduct relating to conduct occurring within a bankruptcy case, neither section 524(e) of the Bankruptcy Code nor the Ninth Circuit law . . . is relevant because those limits apply to third-party releases of claims based on prepetition conduct."[123]

While it is true that exculpation clauses and other forms of nondebtor releases in many ways "raise different issues,"[124] this Note takes a more expansive view of the term "nondebtor release" that includes exculpation clauses for two reasons. First, such clauses literally release nondebtors from liability. Moreover, the Third, Fifth, Seventh, and Ninth Circuits have all encountered exculpation clauses in reorganization plans and treated them as nondebtor releases. These circuits analyze the same statutes and weigh the same considerations in determining the validity of exculpation clauses as they would in determining the validity of other forms of nondebtor releases.[125] The fact that exculpation clauses are concerned with post-petition claims while other forms of nondebtor releases are primarily concerned with pre-petition claims is important to note but not so significant as to recategorize exculpation clauses as something other than nondebtor releases.

2. Channeling Injunctions

Channeling injunctions direct claims away from released nondebtor parties to the bankruptcy estate for payment.[126] The channeling injunction is often structured as a quasi-contract in which the released party contributes to the reorganization, thereby "creating a bigger reorganization pot for creditors"[127] in exchange for the release.[128] The released party is shielded from further liability, and the debtor may consequently be shielded from "indirect claims such as suits against parties who would have indemnity or

122. *Id.*

123. *In re* Plant Insulation Co., No. 09-31347, 2012 Bankr. LEXIS 1716, at *58 (Bankr. N.D. Cal. Mar. 15, 2012).

124. Silverstein, *supra* note 18, at 30.

125. *See In re* PWS Holding Corp., 228 F.3d 224, 245–47 (3d Cir. 2000); Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 749–50, 759–62 (5th Cir. 1995); Airadigm Commc'ns., Inc. v. FCC (*In re* Airadigm Commc'ns., Inc.), 519 F.3d 640, 655–58 (7th Cir. 2008); *Blixseth*, 961 F.3d at 1081–85.

126. Silverstein, *supra* note 5, at 24.

127. Brubaker, *supra* note 2, at 1036.

128. *See* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 655 (6th Cir. 2002) (describing the channeling injunction at issue as "quid pro quo" for funds contributed by the debtor, the debtor's insurers, and the debtor's shareholders).

contribution claims against the debtor."[129] The claimant is promised payment, but such payment is not necessarily certain.[130] While some commentators define channeling injunctions as requiring payment in full on the claim,[131] courts have referred to nondebtor releases as "channeling" where full payment was not anticipated.[132] As discussed further below, this Note will refer to "channeling injunctions" when plans provide for full payment (or substantially full payment) of enjoined creditors' claims and to "actual releases" when they do not.

Opponents of channeling injunctions argue the injunction leaves creditors only with a claim against the debtor, "without even purporting to address the merits of the released non-debtor claim."[133] Opponents also criticize channeling injunctions for shifting the risk of reorganization failure from the released nondebtor to the creditor.[134] If the fund to which the released claims are being channeled proves insufficient to satisfy all claims, which could happen if the reorganization fails, the creditor may not receive full payment.

Courts that have approved the use of channeling injunctions argue that the enjoined claims are not extinguished, they are simply "channeled" to the fund for payment.[135] Though the channeling injunction will be forced on some creditors, in many instances it may provide a more efficient means of recovery. Channeling injunctions are commonly used in the mass tort context, in which thousands, if not hundreds of thousands, of unsecured tort claimants are vying for recovery. In such circumstances, levying a judgment against the debtor might be exceedingly unlikely in the absence of a channeling injunction. Without the injunction, nondebtors will have no incentive to contribute to the reorganization effort. And without the nondebtors' contributions, the likelihood of liquidation may increase, which will in turn decrease the chances of recovery for unsecured tort victims.[136] Moreover, unsecured tort victims may face even greater challenges in

129. *See, e.g.*, Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989).

130. *See In re* Dow Corning Corp., 280 F.3d at 653 (noting an initial $4.225 billion global settlement fund collapsed after "hundreds of thousands more women than anticipated filed claims").

131. *See* Silverstein, *supra* note 5, at 24 ("Third-party releases of claims paid in full are often denoted 'channeling releases' because the claims against the non-debtors are 'channeled' to the estate for full payment.").

132. *In re* Drexel Burnham Lambert Grp., Inc., 138 B.R. 723, 754 (Bankr. S.D.N.Y. 1992); *In re* Am. Fam. Enters., 256 B.R. 377, 392 (D.N.J. 2000).

133. Brubaker, *supra* note 2, at 1039.

134. *See* Silverstein, *supra* note 5, at 81.

135. *See, e.g.*, MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 94 (2d Cir. 1988) (noting the enjoined creditor was "not left without a remedy: [i]t may proceed in the Bankruptcy Court against the $770 million settlement fund").

136. *See* discussion *supra* notes 26–33.

pursuing nondebtors personally. If, for example, the creditor's claims against a nondebtor are based on uncertain legal grounds (for example, there is insufficient evidence to prove alter ego theory) or the nondebtor's assets are expected to prove hard to levy upon (for example, the nondebtor's assets are held in offshore accounts), then the nondebtor release might provide the best opportunity for the creditor to recover.[137] Faced with these outcomes, judges may view channeling injunctions as more efficient and just than any available alternative. Creditors might not get the opportunity to make their claims in a courtroom, but at least they will not be left empty-handed.

3. Actual Releases

This Note draws from Joshua Silverstein's term of "actual releases" to refer to nondebtor releases that do not provide for full payment of an enjoined creditor's claim.[138] Actual releases are by far the most controversial form of nondebtor release as they function essentially as forced settlements of otherwise valid claims that a creditor may wish to pursue. Actual releases vary in scope, ranging from "global" releases barring any and all claims against a nondebtor,[139] to relatively narrow releases protecting a nondebtor from a specific claim by a specific creditor.[140] Generally, to overcome the inherent inequity in extinguishing a claim against the creditor's will without providing full payment, there must be "truly unusual circumstances" that warrant the use of an actual release.[141]

While majority courts are usually willing to approve of exculpation clauses and channeling injunctions, when faced with actual releases, majority courts wade into much greyer territory and must make decisions on a case-by-case basis. Courts analyzing actual releases look to a number of factors in determining their appropriateness: proportion of creditor approval, the amount enjoined creditors will be paid under the reorganization plan, the relevancy of the released claims to the claims against the debtor, whether the

137. *See In re* Purdue Pharma L.P., 633 B.R. 53, 93, 99–100 (Bankr. S.D.N.Y.) ("It is incredibly frustrating that the law recognizes, albeit with some exceptions, although fairly narrow ones, the enforceability of spendthrift trusts. It is incredibly frustrating that people can send their money offshore in a way that might frustrate U.S. law. It is frustrating, although a long-established principle of U.S. law, that it is so difficult to hold board members and controlling shareholders liable for their corporation's conduct. . . . But those things are all facts that anyone who is a fiduciary for the creditor body would have to recognize, and that I recognize."), *vacated*, 2021 WL 5979108 (S.D.N.Y. 2021), *certificate of appealability granted*, No. 21-cv-7532, 2022 WL 121393 (S.D.N.Y. Jan. 7, 2022).

138. Silverstein, *supra* note 5, at 24.

139. *See, e.g.*, Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1397 (9th Cir. 1995) (purported plan to release "numerous parties . . . from all claims" without providing compensation to the enjoined creditors).

140. *See, e.g.*, *In re* Ingersoll, Inc., 562 F.3d 856, 865 (7th Cir. 2009).

141. *See* Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 143 (2d Cir. 2005).

release is narrowly tailored, the likelihood of creditor recovery in the absence of funding given in exchange for the release, and importance of the nondebtor release to the reorganization plan, among others.[142]

II. NONDEBTOR RELEASES IN THE NINTH CIRCUIT

With this background established, the Note will turn its focus to the Ninth Circuit's evolution on the issue of nondebtor releases. This Part will review three primary decisions on nondebtor releases that preceded *Blixseth* to provide context for the subsequent analysis of the *Blixseth* decision. This Part will then compare the decisions to determine how *Blixseth* revised the court's stance on the issue and what that portends for the future of nondebtor releases in the Ninth Circuit.

A. PRE-*BLIXSETH* DECISIONS

The Ninth Circuit's stance on nondebtor releases prior to *Blixseth* can be traced to three primary decisions that build upon each other in important ways. In the first decision, *Underhill v. Royal*, the court looked to the legislative history of § 524(e). Next, *In re American Hardwoods* examined the scope of bankruptcy courts' equitable powers under § 105(a). Finally, in *Resorts International v. Lowenschuss* the court reinforced those decisions and seemed to foreclose the possibility of any nondebtor releases being approved in the Ninth Circuit.

1. *Underhill v. Royal*

Underhill involved the Chapter 11 case of National Mortgage Exchange of Southern California ("NMESC"), which had operated an unsuccessful "loan agreement" program that ultimately resulted in numerous securities

142. *See* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002) (establishing the following factors: "(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions."); *In re Ingersoll, Inc.*, 562 F.3d at 865 (requiring the release to be "narrowly tailored and critical to the plan as a whole"); *In re* Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994) (listing similar factors to those adopted by the Sixth Circuit in *In re Dow Corning Corp.*); *see also* Myers v. Martin (*In re* Martin), 91 F.3d 389, 393 (3d Cir. 1996) (recognizing four criteria bankruptcy courts should weigh in evaluating the appropriateness of settlements: "(1) the probability of success in litigation; (2) the likely difficulties in collection; (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors").

law violation claims that drove it into bankruptcy.[143] NMESC proposed a reorganization plan in which creditors would immediately be refunded fifty percent of their principal.[144] The noteholders involved in the program were classified as unsecured creditors with claims totaling nearly $4.5 million.[145] The proposal also contained a provision releasing NMESC, any affiliate of NMESC, and any insider of NMESC from all noteholder claims.[146]

The bankruptcy court approved the reorganization plan over the objections of some creditors but deferred to the district court regarding the validity of the release.[147] The district court rejected the release, concluding the bankruptcy court "could not discharge the liability of a nondebtor as part of a reorganization plan to discharge the liability of the debtor."[148] NMESC's president was later found liable for securities law violations by the district court, but he appealed the ruling, arguing that the release barred the claims against him.[149]

In affirming the district court's determination that the release was invalid, the Ninth Circuit looked to the legislative history of § 524(e), which "underscore[d] the limitations on the bankruptcy court."[150] Citing the Seventh Circuit case of *Union Carbide Corp. v. Newboles*—which was decided under a prior version of the Bankruptcy Code and was later overruled by the Seventh Circuit in *In re Airadigm Communications*—the Ninth Circuit concluded the "broad" language of § 524(e) limits the scope of discharge so that it "does not affect the liability of any other entity."[151] Therefore, the release was invalid.

2. *In re American Hardwoods*

The Ninth Circuit reinforced its stance on nondebtor releases a few years later in *In re American Hardwoods*, which contains the circuit court's most thorough discussion of whether bankruptcy courts have the authority to approve nondebtor releases. The case involved an attempt by the debtor corporation, American Hardwoods, to enjoin its largest creditor from pursuing a state court claim against the debtor's insiders, who had guaranteed the corporation's debt.[152] The bankruptcy court approved a temporary

143. Underhill v. Royal, 769 F.2d 1426, 1428–30 (9th Cir. 1985).
144. *Id.* at 1430.
145. *Id.* at 1429.
146. *Id.* at 1429–30.
147. *Id.* at 1430.
148. *Id.* at 1432.
149. *Id.* at 1431–32.
150. *Id.* at 1432.
151. *Id.*
152. Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621,

injunction barring the creditor, Deutsche Credit Corporation, from enforcing any state court judgment against the insiders, but ultimately determined it lacked both jurisdiction and authority to order a permanent injunction restraining Deutsche. The district court affirmed.[153]

On appeal, the Ninth Circuit agreed, ruling the bankruptcy court lacked the authority to issue the permanent injunction. The court first reviewed the language of § 105(a) and adopted a narrow view of the statute, holding § 105(a) does not permit the bankruptcy court to issue orders "absent specific statutory authority" or "in a manner not specifically provided for" in the Code.[154] Moreover, the section "does not authorize relief inconsistent with more specific law."[155] The relevant "more specific law" in this case being § 524(e).

The Ninth Circuit reiterated its interpretation of the statute established in *Underhill*, concluding that the section "limits the court's equitable power under section 105 to order the discharge of the liabilities of nondebtors."[156] Because the insiders were American's guarantors, the insiders and American shared liability on the same debts. A permanent injunction shielding the insiders from liability on American's debt would violate § 524(e), and therefore "the specific provisions of section 524 displace the court's equitable powers under section 105 to order the permanent relief sought by American."[157]

3. *Resorts International v. Lowenschuss*

In *Resorts International v. Lowenschuss*, the Ninth Circuit appeared to foreclose the possibility of the approval of any nondebtor release. There, the debtor corporation's reorganization plan contained a "Global Release Provision" which granted "global releases" from all claims against the debtor and several persons and entities related to the debtor.[158] The provision also released all liens and "satisf[ied] . . . all outstanding judgments, executions, and levies" against the debtor and the related entities.[159] The bankruptcy court approved the plan, but on appeal, the district court vacated the Global Release Provision. The debtor appealed the decision. With an apparent lack of patience, the Ninth Circuit said the court "has repeatedly held, without

622–23 (9th Cir. 1989).

153. *Id.*

154. *Id.* at 625.

155. *Id.*

156. *Id.* at 626.

157. *Id.*

158. Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1398, 1401 (9th Cir. 1995).

159. *Id.* at 1401.

exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors."[160] Rather than reiterate its position on nondebtor releases, the court pointed to its holdings in *Underhill* and *American Hardwoods* and affirmed the district court's decision.[161]

B. *BLIXSETH*'S REVISION

Blixseth v. Credit Suisse involved the Chapter 11 case of the Yellowstone Club, a luxury, members-only residential community in Big Sky, Montana.[162] The club's owner, Timothy Blixseth, arranged for Credit Suisse to lend Yellowstone Club $375 million to fund the global expansion of the club's operations.[163] Blixseth immediately "mismanaged and misused" the loan proceeds,[164] diverting around half of the monies to "various personal accounts and payoffs benefitting" himself and his wife, Edra.[165] Subsequently, in 2008, Blixseth and Edra divorced, and Edra was awarded ownership of the various Yellowstone Club entities.[166] A few months later, she filed a Chapter 11 case with the ultimate goal of selling the assets of the Yellowstone Club entities to CrossHarbor Capital Partners, a real estate management company.[167]

Following the filing of Yellowstone Club's Chapter 11 petition, the various parties to the bankruptcy case began sparring over the company's assets.[168] Blixseth, Credit Suisse, CrossHarbor, the Yellowstone Club, and a committee of unsecured creditors threatened each other with lawsuits, and Blixseth filed actions against CrossHarbor and several attorneys involved in the proceedings.[169] Given the aggressive posture of the parties, the bankruptcy court noted an exculpation clause was "certainly advisable."[170] During cross-examination at the bankruptcy proceedings, an attorney involved in the fracas explained the rationale behind including the exculpation clause in Yellowstone's reorganization plan.

160. *Id.* at 1401, 1398–1401.
161. *Id.* at 1402.
162. Blixseth v. Kirschner (*In re* Yellowstone Mountain Club, LLC), 436 B.R. 598, 607 (Bankr. D. Mont. 2010).
163. *Id.* at 608–60.
164. Blixseth v. Credit Suisse, 961 F.3d 1074, 1078 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021).
165. Blixseth v. Kirschner (*In re* Yellowstone Mountain Club, LLC), 436 B.R. 598, 614 (Bankr. D. Mont. 2010).
166. *Id.* at 632.
167. *Blixseth*, 961 F.3d at 1078.
168. *Id.*
169. *In re* Yellowstone Mountain Club, LLC, 460 B.R. 254, 274 (Bankr. D. Mont. 2011).
170. *Id.*

> [P]rofessionals, on behalf of the people they represent in cases, battle each other tirelessly for a period of time. And things are said, and feelings are hurt, and "oxes" are gored. And there needs to be repose at the end of the case. . . . [A]nd for me that's the most important thing, "This is the end of it, we're done."[171]

The Yellowstone Club's "Second Amended Reorganization Plan and Disclosure Statement" included such an exculpation clause, but Credit Suisse and Blixseth were not included.[172] Both parties objected, arguing "such releases are strictly forbidden in the Ninth Circuit."[173] The objection of Credit Suisse, the Yellowstone Club's largest creditor by far, "threatened the confirmation of the plan . . . ."[174] The parties scrambled over the course of a weekend to create a new reorganization plan to avoid liquidation. This time, Credit Suisse gained the status of an exculpated party, but Blixseth remained unprotected.[175] As amended, the exculpation clause provided that none of the exculpated parties, including the Yellowstone Club, CrossHarbor, the unsecured creditors committee, Edra Blixseth, and Credit Suisse,

> shall have or incur any liability to any Person for any act or omission in connection with, relating to or arising out of the Chapter 11 Cases, the formulation, negotiation, implementation, confirmation or consummation of this Plan, the Disclosure Statement, or any contract, instrument, release or other agreement or document entered into during the Chapter 11 Cases or otherwise created in connection with this Plan; provided, however, that nothing in this Section 8.4 shall be construed to release or exculpate any Exculpated Party from willful misconduct or gross negligence . . . .[176]

The bankruptcy court approved the plan over Blixseth's objections, but the district court reversed, finding the exculpation clause overly broad.[177]

The case was ultimately appealed to the Ninth Circuit twice. In its initial, unpublished decision, the Ninth Circuit determined Blixseth's challenge to the clause was not equitably moot and remanded the case to the district court to rule on the merits of the case.[178] After the district court failed

171. *Id.*
172. Blixseth v. Credit Suisse, 961 F.3d 1074, 1078 (9th Cir. 2020).
173. *Id.*
174. *Id.*
175. *Id.* (noting that Blixseth again objected to the Plan).
176. *Id.* at 1078–79.
177. *Id.* at 1079. The district court concluded the exculpation clause went "well beyond the limitation of Section 524(e)." Blixseth v. Yellowstone Mountain Club, LLC, No. CV-09-47, 2010 U.S. Dist. LEXIS 118803, at *5 (D. Mont. Nov. 2, 2010). The court indicated it was unclear which parties were covered by the exculpation clause and requested the bankruptcy court to "explicitly identify and delineate" who was protected by the release. *Id.*
178. Blixseth v. Credit Suisse, 961 F.3d 1074, 1079 (9th Cir. 2020) (noting "Blixseth's challenge . . . was not equitably moot because it was 'apparent that one or more remedies [was] still

to do so, Blixseth appealed to the Ninth Circuit a second time.[179]

Blixseth reads § 524(e) to prevent "a bankruptcy court from extinguishing claims of creditors against non-debtors over the very debt discharged through the bankruptcy proceedings."[180] In other words, discharge protects the debtor from attempts to collect but in no way "absolve[s] a non-debtor's liabilities for that *same* 'such' debt."[181] The distinction between claims based on the underlying debt and claims independent of the debt is more explicit in § 16 of the 1898 Bankruptcy Act, which emphasized the liability of "co-debtors and guarantors, but not creditors or other third parties."[182] Much like its predecessor, § 524(e) prevents a reorganization plan from wiping away a creditor's claims against co-debtors, guarantors, or similar third parties liable for the discharged debt. But neither § 524(e), nor its predecessor, would apply to an exculpation clause for negligent acts committed during the formulation of a Chapter 11 plan, as claims for such acts are not based on the underlying debt.[183]

The Ninth Circuit proceeded to distinguish the exculpation clause in *Blixseth* from the other releases in *Underhill*, *American Hardwoods*, and *Lowenschuss*. Each of those cases "involved sweeping nondebtor releases from creditors' claims on the debts discharged in the bankruptcy," as opposed to the narrow exculpation clause in *Blixseth*.[184] Those releases affected the ability of creditors to "make claims against third parties, including guarantors and co-debtors, for the debtor's discharged debt."[185] The clause in Yellowstone's reorganization plan did nothing more than allow the settling parties "to engage in the give-and-take of the bankruptcy proceeding without fear of subsequent litigation over any potentially negligent actions in those proceedings."[186] *Blixseth* described exculpation clauses as "commonplace provision[s]" designed to preclude subsequent litigation over actions taken during the bankruptcy proceedings and ensure the viability of the reorganization plan.[187]

The Ninth Circuit argued that § 105(a), in conjunction with § 1123(b)(6), which grants bankruptcy courts the authority to approve reorganization plans that "include any other appropriate provision not

available' ").

179. *Id.*
180. *Id.* at 1082.
181. *Id.* at 1083.
182. *Id.*
183. *Id.*
184. *Id.* at 1083–84.
185. *Id.* at 1084.
186. *Id.*
187. *Id.* at 1084–85.

inconsistent with the" Code,[188] permit "exculpation clause[s] intended to trim subsequent litigation over acts taken during the bankruptcy proceedings and so render the Plan viable."[189] Furthermore, because exculpation clauses do not run afoul of § 524(e), they are valid.[190] This seems to imply that so long as a § 105(a) order does not violate another provision of the Code, it may be acceptable. But in *American Hardwoods*, the Ninth Circuit held that § 105(a) did not allow bankruptcy courts to issue orders "absent specific statutory authority," as there is no statutory grant of authority to release nondebtors from liability for negligent acts related to the Chapter 11 case, with the express exception for creditors' committees in § 1103(c).[191] In fact, in an opinion issued the day before *Blixseth*, the Ninth Circuit noted § 105(a) "is not a substantive grant of authority."[192] While it may be difficult to reconcile these two positions, it seems clear that the Ninth Circuit holds a fairly restrictive view of § 105(a)'s grant of equitable powers. *Blixseth* repeatedly emphasized the narrow nature of the release, suggesting broader releases and injunctions might run afoul of § 105(a)'s requirement that the order be necessary or appropriate to carrying out the provisions of the Code.[193]

Ultimately, the Ninth Circuit in *Blixseth* moves from a broad interpretation of § 524(e) that views the section as a per se bar on nondebtor releases to a strong narrow view of the statute that restricts its applicability to releases that affect nondebtor liability on the discharged debt. Releases limiting a nondebtor's liability on claims independent of the discharged debt will probably continue to be denied, however, unless they are sufficiently narrow and essential to the reorganization such that the court deems them

188. 11 U.S.C. § 1123(b)(6).

189. Blixseth v. Credit Suisse, 961 F.3d 1074, 1084 (9th Cir. 2020).

190. *See id.* at 1084–85.

191. Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 625 (9th Cir. 1989). The Third Circuit in *In re PWS Holding Corp.* approved the use of an exculpation clause on the grounds that the clause adhered to the same standard of liability as that purportedly laid out in § 1103(c). *In re PWS Holding Corp.*, 228 F.3d 224, 247 (3d Cir. 2000). Some bankruptcy courts in the Ninth Circuit later adopted this line of reasoning, extending the release of liability for creditors' committees to other parties. *See In re* WCI Cable, Inc., 282 B.R. 457, 476–77, 479–80 (Bankr. D. Or. 2002) (extending release of liability provided in § 1103(c) to additional parties, "*but only* if the exculpation exceptions are extended to cover negligence and breaches of fiduciary duty as well as gross negligence and willful misconduct"); *In re* Lighthouse Lodge, LLC, No. 09-52610-RLE, 2010 Bankr. LEXIS 3663, at *20, *26–27 (Bankr. N.D. Cal. Oct. 14, 2010) (conditioning approval of exculpation clause on exclusions for gross negligence or willful misconduct to align with the standards of § 1103(c)). The Ninth Circuit implicitly rejected this extension of § 1103(c), holding that Credit Suisse "does not have an implied fiduciary duty derived from the statute to the participants of the bankruptcy proceedings" and thus falls outside of § 1103(c)'s reach. *Blixseth*, 961 F.3d at 1085 n.8.

192. Albert-Sheridan v. State Bar of Cal. (*In re* Albert-Sheridan), 960 F.3d 1188, 1196 n.7 (9th Cir. 2020).

193. *See Blixseth*, 961 F.3d at 1081–85.

appropriate.[194] Moreover, *Blixseth* arguably adopts a broader interpretation of § 105(a) than its previous decisions dealing with nondebtor releases, but it is unclear how much significance to give this apparent adjustment, considering the day before *Blixseth* was issued, the Ninth Circuit seemed to reaffirm its original, narrower interpretation.

C. IMPLICATIONS FOR NONDEBTOR RELEASES IN THE NINTH CIRCUIT

The adjustments reflected in *Blixseth* show a fundamental alteration of the court's stance on nondebtor releases, and the severing of ties to the minority view jurisdictions. Now, based on the Ninth Circuit's interpretations of § 524(e), the Ninth Circuit is more closely aligned with the majority of jurisdictions that do not view the Code as a per se prohibition on nondebtor releases. It is important to note, however, the incremental nature of this shift. *Blixseth* held that only necessary, narrowly tailored exculpation clauses are valid under § 105(a). The court does not speculate as to whether channeling injunctions, actual releases, or even broader forms of exculpation clauses may be approved under the rules established in *Blixseth*.

The Ninth Circuit has not ruled on the validity of channeling injunctions, but it seems unlikely that *Blixseth* would increase their chances of approval. Channeling injunctions typically arise in situations in which a nondebtor wishes to shield itself from further liability on the discharged debt through a quasi-contract that establishes a fund from which claimants may draw upon in exchange for the release.[195] The motivating force behind channeling injunctions, therefore, is to affect third party liability on the discharged debt, which directly violates the strong narrow interpretation of § 524(e) adopted by the Ninth Circuit in *Blixseth*.

Even if the Ninth Circuit determined that a particular channeling injunction survived § 524(e), the court's restrictive view of § 105(a) would likely result in the injunction's disapproval. *Blixseth* narrowly concluded that § 105(a) granted to bankruptcy courts "authority to approve an exculpation clause intended to trim subsequent litigation over acts taken during the bankruptcy proceedings and so render the Plan viable."[196] While the Ninth Circuit did not attempt to define the boundaries of bankruptcy courts' equitable powers under § 105(a), the specificity of its conclusion indicates hesitancy to grant bankruptcy courts increased power to modify nondebtor liability.

194. *See id.* at 1084 (noting that "rather than provide an unauthorized 'fresh start' to a non-debtor, . . . the Clause does nothing more than allow the settling parties . . . to engage in the give-and-take of the bankruptcy proceeding").

195. *See* discussion *supra* Section I.C.2.

196. Blixseth v. Credit Suisse, 961 F.3d 1074, 1084 (9th Cir. 2020).

On the other hand, because the Ninth Circuit previously has not ruled on the validity of channeling injunctions, it might enjoy some maneuverability to permit them in certain circumstances. If the court had a desire to approve a particular channeling injunction, it might find support from the Fifth Circuit. In *Feld v. Zale*, the Fifth Circuit—which is best described as a minority view jurisdiction—entertained the idea that a nondebtor release might be valid if it channeled the enjoined claim to another source of funds.[197] Channeling injunctions, the court said, have been found valid in other circuits where the enjoined claims are redirected to an alternative source of recovery, "thereby avoid[ing] discharging the nondebtor."[198] In *Feld*, the exculpation clause at issue provided no alternative means of recovery.[199] The bankruptcy court that approved the exculpation clause therefore "exceeded its powers under § 105" by improperly discharging a potential debt of a nondebtor.[200] This holding implies that if the exculpation clause had provided an alternative source of recovery, the bankruptcy court would not have exceeded its grant of equitable powers under § 105(a) and the release would have been valid. If the Ninth Circuit were to take a similar view of the mechanisms of a channeling injunction, it might be willing to approve them in certain circumstances. The Fifth Circuit, however, has embraced a liberal view of § 105(a).[201] The Ninth Circuit's more restrictive view of the statute might not permit bankruptcy courts to approve channeling injunctions.

Actual releases will almost certainly continue to be disapproved in the Ninth Circuit after *Blixseth*. Even if one can imagine an actual release that would survive the Ninth Circuit's strong narrow interpretation of § 524(e), the proponent of the release would need to demonstrate that the release was sufficiently narrow and necessary to fall within the bankruptcy court's equitable powers under § 105(a). In *In re Ingersoll*, the Seventh Circuit encountered an actual release that it concluded met similar requirements. The actual release at issue enjoined a third-party law firm from pursuing attorney's fees against nondebtor insiders of the debtor company.[202] The release did not affect third party liability on the discharged debt, as the attorney's fees were only tangentially related to the Chapter 11 case. The Seventh Circuit held the release was appropriate under § 105(a) because it only barred claims related to the attorney's fees dispute, and the insiders

197. *See* Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) (holding § 524(e) categorially "prohibits the discharge of debts of nondebtors").

198. *Id.* at 760.

199. *Id.*

200. *Id.* at 761.

201. *See id.* at 760 ("[W]e interpret § 105 liberally.").

202. *See id.* at 859–62.

bargained for the release in exchange for "valuable consideration" that would enable unsecured creditors of the debtor corporation to benefit from distribution.[203] This release, in other words, was appropriate because it specifically targeted a discrete legal dispute, and it was necessary because its inclusion in the reorganization plan allowed unsecured creditors some degree of recovery.

The Ninth Circuit, on the other hand, would most likely disagree with this analysis. First, the reasoning adopted by the Seventh Circuit in *Ingersoll* could allow for the dismissal of any pending litigation, no matter how tangentially related to the Chapter 11 case. So long as the nondebtor contributes necessary funds to the reorganization process and predicates that "valuable consideration" on release from whatever liability the nondebtor is facing, the rule established in *Ingersoll* could result in the approval of such a nondebtor release. Wary of this outcome, the Seventh Circuit explicitly noted that "[i]n most instances, releases like the one here will not pass muster" under the rules it applied in its decision.[204] The court's reasoning, however, still leaves open the possibility that parties to the reorganization could essentially buy their way out of unrelated legal disputes through the bankruptcy court.[205] This line of reasoning is unlikely to be embraced in the Ninth Circuit given its hesitancy to expand the equitable powers of bankruptcy courts or approve nondebtor releases outside of specific circumstances.

Moreover, the exculpation clause at issue in *Blixseth* barred prospective claims only for negligent acts or omissions that occurred during the Chapter 11 case. The scope of the release was limited in both scope and time. The purpose of the clause was not to void an action already filed but to establish guidelines and expectations for how the Chapter 11 negotiations would proceed, according to the court. A permanent injunction specifically targeting a dispute that had already spawned active legal battles would be viewed by the Ninth Circuit as an entirely different matter. Such an injunction would encroach upon the jurisdiction of nonbankruptcy courts and arguably violate the due process rights of the enjoined party.[206] The Seventh

203. *Id.* at 865.

204. *Id.*

205. Wary of this possibility, one bankruptcy court held "a non-debtor release is not justifiable simply on the ground that it was offered in exchange for a monetary contribution." *In re* Residential Capital, LLC No. 12-12020, 2014 Bankr. LEXIS 1810, at *24 (Bankr. S.D.N.Y. Apr. 23, 2014) (interpreting Second Circuit precedent on the validity of nondebtor releases).

206. *See* Dorothy Coco, Note, *Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law*, 88 FORDHAM L. REV. 231, 247 (2019) (noting nondebtor releases "may deprive individuals of a fundamental right and interfere with the free exercise of the rights of individuals forced into accepting these releases").

Circuit in *In re Ingersoll* overlooked these issues, valuing the success of the reorganization and the possibility of unsecured creditor recovery over the fairness to the enjoined creditor. The Ninth Circuit would be much more critical of the appropriateness of such a release.

In sum, it is unlikely that the Ninth Circuit will significantly expand beyond *Blixseth*'s holdings that exculpation clauses releasing parties to the reorganization from negligence claims related to the formulation of the reorganization plan do not violate § 524(e) and that a bankruptcy court does not exceed its § 105(a) powers in approving such exculpation clauses so long as they are sufficiently narrow and necessary to the reorganization.

III. AN ALTERNATIVE APPROACH

Up to this point, this Note has attempted to elucidate the shift the Ninth Circuit made in *Blixseth* regarding the validity of nondebtor releases. This Part will argue that while the Ninth Circuit's decision in *Blixseth* is a step in the right direction, the Bankruptcy Code permits a more liberal stance on nondebtor releases. Specifically, this Note argues the negative interpretation of § 524(e) and the liberal interpretation of § 105(a) are the most correct readings of those statutes. Moreover, a framework that analyzes nondebtor releases' appropriateness, necessity, and consistency with the Code on a case-by-case basis is the best method by which bankruptcy courts may determine the validity of a nondebtor release. This framework adheres to standards supplied by the Bankruptcy Code and Supreme Court precedent, and it sufficiently balances the goals of Chapter 11 with the potential for abuse posed by nondebtor releases.

A. THE NEGATIVE VIEW OF § 524(E) IS THE MOST ACCURATE INTERPRETATION

How courts interpret § 524(e) largely determines what forms of nondebtor releases, if any, the court will permit. As such, it is arguably the most important Code provision bearing on the issue of nondebtor releases. Most jurisdictions read into the section an affirmative prohibition on at least some forms of nondebtor releases.[207] But the plain language of the statute contains no such prohibition. The negative view of § 524(e) is therefore the correct view.

Many courts that find an affirmative prohibition on nondebtor releases in § 524(e) turn to the section's predecessors in prior versions of the Bankruptcy Code.[208] Each of these statutes contained mandatory language

207. *See supra* text accompanying notes 61–77.
208. *See, e.g.*, *In re* Linda Vista Cinemas, L.L.C., 442 B.R. 724, 742 (Bankr. D. Ariz. 2010).

that in fact prohibited nondebtor releases.[209] As the Ninth Circuit pointed out in *Underhill v. Royal*, § 16 of the 1898 Bankruptcy Act provided that "the liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt."[210] Section 4(b) of the 1898 Act provided that a Chapter 11 discharge "shall not" release the debtor corporation's "officers, the members of its board of directors or trustees or of other similar controlling bodies, or its stockholders or members, as such, from any liability."[211] These statutes unambiguously restricted the power of bankruptcy courts to enjoin creditor claims against nondebtors.

Section 524(e), on the other hand, contains no mandatory language. It merely states that discharge "does not" alter third party liability on the discharged debt.[212] The Ninth Circuit in *Blixseth*, perhaps struggling to reconcile the broad language used in *Resorts International v. Lowenschuss*, slightly restricted the reach of the statute by applying it only to releases that affect third party liability on the discharged debt. *Blixseth*, however, does not address the lack of mandatory language in statute.

This subtle but important distinction was not lost on other circuit courts, particularly the Seventh Circuit. That court determined that had Congress intended the section to "limit the bankruptcy court's powers to release a non-debtor from a creditor's claims, . . . it would have used the mandatory terms 'shall' or 'will' rather than the definitional term 'does.' "[213] Viewing the statute as a per se prohibition on nondebtor releases is a "misreading of the statute."[214] Even the Fifth Circuit, which views § 524(e) as a per se prohibition on nondebtor releases, said that "the statute does not by its specific words preclude" discharge of a nondebtor.[215] Indeed, a leading commentator opposed to the use of nondebtor releases found the reliance on § 524(e) as a bar on nondebtor releases to be "misguided and unfortunate."[216]

The Seventh Circuit described the section as a "saving clause,"[217] correctly noting that it is designed to limit the operation of § 524(a), which

209. *See supra* text accompanying notes 56–59.

210. Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985) (quoting Act of July 1, 1898, ch. 541, § 16, 30 Stat. 550 (repealed 1978)).

211. *Id.* (quoting Act of June 22, 1938, ch. 575, § 4(b), 52 Stat. 845 (repealed 1978)).

212. *In re* Master Mortg. Inv. Fund, Inc., 168 B.R. 930, 936 (Bankr. W.D. Mo. 1994) (adopting the negative interpretation of § 524(e) because "the language is clear, and the Court need not look to the statutory precursor of § 524").

213. Airadigm Commc'ns, Inc. v. FCC (*In re* Airadigm Commc'ns, Inc.), 519 F.3d 640, 656 (7th Cir. 2008).

214. *In re* Specialty Equip. Cos., 3 F.3d 1043, 1047 (7th Cir. 1993).

215. Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1050 (5th Cir. 1987).

216. Brubaker, *supra* note 2, at 971.

217. *In re Airadigm Commc'ns, Inc.*, 519 F.3d at 656.

sets forth the effect, or lack thereof, of the debtor's discharge.[218] Section 524(e) is necessary, "as a matter of mere mechanics, to prevent the debtor's discharge from automatically discharging co-debtors and guarantors, through the operation of common-law suretyship rules that release secondary obligors upon release of the primary obligor."[219] Section 39 of the Third Restatement of Suretyship & Guaranty, for example, provides that "[t]o the extent that the obligee releases the principal obligor[,] . . . the secondary obligor is discharged from any unperformed duties pursuant to the secondary obligation" unless an exception to the rule applies.[220] Section 524(e) makes that rule inapplicable in bankruptcy and preserves the rights of creditors to "seek to collect a debt from a co-debtor who did not participate in the reorganization—even if that debt was discharged as to the debtor in the plan."[221]

This reading of § 524(e) does not occur in a "vacuum."[222] This interpretation acknowledges that each of the section's predecessors contained the mandatory "shall" as opposed to the descriptive "does."[223] Such a crucial difference should not be taken lightly. Moreover, Congress clearly knew the difference between mandatory and descriptive language, as evidenced by numerous statutes containing the words "shall" or "will" or similarly commanding verbs.[224] Nor does the negative view of § 524(e) conflict with any other provision of the Code or render any other provision redundant.

Some commentators argue that when read in conjunction with § 524(a), § 524(e)'s *intended* purpose as a prohibition on nondebtor releases is made manifest.[225] Because § 524(a) describes only the effect of discharge on the "personal liabilit[ies] of the debtor,"[226] § 524(e) could be duplicative if interpreted in a manner that finds no affirmative prohibition in the statute,

218. *See* 11 U.S.C. § 524(a) ("[D]ischarge . . . operates as an injunction against . . . an act, to collect, recover or offset any such debt as a personal liability of the debtor . . . .").

219. Brubaker, *supra* note 2, at 971–72.

220. RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 39 (AM. L. INST. 1996).

221. Airadigm Commc'ns, Inc. v. FCC (*In re* Airadigm Commc'ns, Inc.), 519 F.3d 640, 656 (7th Cir. 2008).

222. Boyle, *supra* note 43, at 437.

223. *See* Act of Apr. 4, 1800, ch. 19, § 34, 2 Stat. 19 (repealed 1803); Act of Aug. 19, 1841, ch. 9, § 4, 5 Stat. 440 (repealed 1843); Act of Mar. 2, 1867, ch. 176, § 33, 14 Stat. 517 (repealed 1878); Act of July 1, 1898, ch. 541, § 16, 30 Stat. 550 (repealed 1978).

224. *Compare* 11 U.S.C. § 704(a)(3) (holding the trustee "shall be" accountable for all property received), *with id.* § 706(a) (providing the debtor "may" convert a Chapter 7 case to a Chapter 11, 12, or 13 case). *See also In re Airadigm Commc'ns, Inc.*, 519 F.3d at 656 (noting that "where Congress has limited the powers of the bankruptcy court, it has done so clearly—for example, by expressly limiting the court's power . . . or by creating requirements for plan confirmation").

225. Boyle, *supra* note 43, at 437.

226. 11 U.S.C. § 524(a).

according to this line of reasoning. Subsection (a), however, does not speak to the secondary impacts of the discharge of the debtor's personal liabilities. Subsection (e) fills that gap by establishing that a discharge "does not affect the liability of [third parties]."[227] In fact, the following subsection, which says "nothing contained in subsection (c) or (d) of this section prevents a debtor from voluntarily repaying any debt" is another savings clause that limits the operation of the two listed subsections.[228] Contrary to claims that the negative view of § 524(e) only makes sense if the section is analyzed in a "vacuum,"[229] full consideration of the Code and the section's predecessors actually reinforces the negative view.

B. THE LIBERAL VIEW OF § 105(A) MOST ALIGNS WITH SUPREME COURT PRECEDENT

The Ninth Circuit's holdings in *American Hardwoods* and *Blixseth* place it in a somewhat awkward position regarding the breadth of bankruptcy courts' powers under § 105(a). On the one hand, *American Hardwoods* held the section prohibited courts from issuing orders "absent specific statutory authority" from the Code.[230] *Blixseth*, on the other hand, seems to stand for the proposition that exculpation clauses do not exceed § 105(a)'s grant of equitable power so long as they are narrowly tailored and "intended to trim subsequent litigation over acts taken during the bankruptcy proceedings and so render the Plan viable."[231] Obviously, there is no specific statutory authority for such an order. These contradictory holdings provide little clarity as to the permissible scope of nondebtor releases, but they do reflect some uneasiness towards the expansion of bankruptcy courts' equitable powers.

Such uneasiness is unnecessary and arguably contrary to the provisions and objectives of the Code. The Supreme Court clearly articulated a liberal view of § 105(a)'s grant of equitable powers in *United States v. Energy Resources Co.*[232] There, the Court decided whether a bankruptcy court was authorized "to order the IRS to treat tax payments made by Chapter 11 debtor corporations as trust fund payments where the court determines that this

227. *Id.* § 524(e); *see also* Silverstein, *supra* note 5, at 127 (noting that in the absence of § 524(e), bankruptcy would "severely undermine the effectiveness of contractual guaranties, among other detrimental results").

228. 11 U.S.C. § 524(f).

229. Boyle, *supra* note 43, at 437.

230. Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 625 (9th Cir. 1989).

231. Blixseth v. Credit Suisse, 961 F.3d 1074, 1084 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021).

232. United States v. Energy Res. Co., 495 U.S. 545, 549–50 (1990).

designation is necessary for the success of a reorganization plan."[233] Under the Internal Revenue Code, employers are required to withhold personal income and Social Security taxes from employees' paychecks. The taxes are referred to as "trust fund" taxes because employers hold the funds in trust for the United States. If an employer fails to pay the collected taxes, the IRS is authorized to collect an equivalent sum from the corporation's "responsible persons," who are the employees responsible for collecting the tax.[234] In addition to trust fund taxes, a corporation may also fail to pay "non–trust fund" taxes, such as its corporate income tax, which may not be collected from third parties.[235]

Energy Resources Co. involved two debtor corporations in Chapter 11 reorganizations who owed both trust fund and non–trust fund taxes.[236] In each case, the bankruptcy court ordered that any payments on the tax debts first go towards the trust fund taxes, and "only after it received enough money to satisfy all trust fund debts" could the government apply the payments to the non-trust fund debts.[237] This benefitted the " 'responsible' [persons]" of the debtor corporations because it made it less likely that they would have to personally pay for the trust fund tax deficiency. On the other hand, the order made it less likely the government would collect the full debt. If it had been able to first apply payments to the non–trust fund debts, it could still pursue payment from the responsible persons even if the reorganization failed and there were insufficient funds for both the trust fund and non–trust fund debts.[238] The two cases were consolidated and appealed to the First Circuit, which affirmed the bankruptcy courts' orders.[239] The IRS appealed to the Supreme Court.

The Supreme Court held that the bankruptcy courts had "not transgressed any limitation on their broad power."[240] While the Bankruptcy Code did not "explicitly authorize" the bankruptcy courts' orders affecting the designation of the tax payments, neither did the Code explicitly prohibit such orders either.[241] Sections 105(a) and 1123(b)(6), on the other hand, grant "broad authority to modify creditor-debtor relationships."[242] Section 105(a) allows bankruptcy courts to issue orders "necessary or appropriate"

233. *Id.* at 546.
234. *Id.*; Silverstein, *supra* note 5, at 90.
235. Silverstein, *supra* note 5, at 100; *see also Energy Res. Co.*, 495 U.S. at 550–51.
236. *Energy Res. Co.*, 495 U.S. at 547.
237. IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 225 (1st Cir. 1989).
238. *Id.*
239. *Id.* at 234.
240. *Energy Res. Co.*, 495 U.S. at 551.
241. *Id.* at 549.
242. *Id.*

to carry out the provisions of the Code, and § 1123(b)(6) grants the "residual authority" to approve any reorganization provision that is "appropriate" and consistent with the Code.[243] An order "might be inappropriate" it if conflicted with a relevant nonbankruptcy law, but the orders at issue in *Energy Resources Co.* did not do so.[244] The Supreme Court concluded that bankruptcy courts "may order the IRS to apply tax payments to offset trust fund obligations where it concludes that this action is *necessary for a reorganization's success*."[245]

Energy Resources Co. has major implications on the permissible scope and content of nondebtor releases. First, the Supreme Court endorsed a liberal view of § 105(a). Bankruptcy courts "possess substantive equitable powers . . . not limited to issuing orders that are tethered to specific sections of the Code."[246] Second, the orders at issue in *Energy Resources Co.* were not explicitly authorized or prohibited by the Code. But because the orders were "appropriate," "necessary," and "not inconsistent" with the Code or other relevant law, the bankruptcy courts were authorized to issue them.[247] These holdings demonstrate the Supreme Court's conclusion that the Bankruptcy Code confers on bankruptcy courts significant equitable powers to modify creditor-debtor relationships to achieve the overarching goal of Chapter 11: reorganization.

While the Ninth Circuit's interpretation of § 105(a) is difficult to define with any precision, it is clearly more restrictive than that adopted by the Supreme Court in *Energy Resources Co*. As such, it artificially limits the bankruptcy court's equitable powers to modify creditor-debtor relationships to achieve reorganization. Whereas the Supreme Court's interpretation of the statute would permit a bankruptcy court to approve any nondebtor release it deems necessary and appropriate to the reorganization, *Blixseth* only permits bankruptcy courts to approve a specific form of nondebtor release in a specific context.[248] In crafting this limitation, the Ninth Circuit abandons potentially useful tools that could assist struggling business organizations in achieving reorganization.

C. LIMITING THE POTENTIAL FOR ABUSE

Practically every circuit court has established its own rules regarding the validity of nondebtor releases. Many of these rules are judicially created

243. *Id.*
244. *Id.* at 550–51.
245. *Id.* at 551 (emphasis added).
246. Silverstein, *supra* note 5, at 105.
247. *Energy Res. Co.*, 495 U.S. at 549–51.
248. *See supra* text accompanying notes 193–14.

and have little foundation in the language of the Code.[249] The Supreme Court's holding in *Energy Resources Co.* that a bankruptcy court is authorized to issue orders that are "appropriate," "necessary," and "not inconsistent" with the Code, on the other hand,[250] provides a framework for bankruptcy courts to analyze nondebtor releases. This framework will be referred to as the "*Energy Resources Co.* test." In addition to adhering to the proscriptions of the Code, the *Energy Resources Co.* test provides courts sufficient flexibility to respond to the varying circumstances in which nondebtor releases occur, and sufficiently limits the potential for abuse in nondebtor releases.

Nondebtor releases vary widely in scope and form, and whether the release is appropriate and necessary will "depend[] on the nature of the reorganization"[251] and is "fact intensive in the extreme."[252] Issuing a formal list of factors, as the Sixth Circuit did in *Dow Corning*,[253] artificially limits bankruptcy courts' equitable powers and may preclude relatively harmless nondebtor releases that do not meet every factor of the court's test but are nevertheless essential to a reorganization. There is also the possibility that crafty attorneys could structure a release to meet whatever factors the court establishes while severely harming some other party's interests. A more malleable approach allows bankruptcy courts to weigh the sometimes-dueling considerations of maximizing creditor recovery and achieving a successful reorganization when evaluating the validity of a particular nondebtor release. While the fluctuating nature of nondebtor releases makes it difficult to formulate the qualities of a valid release under this approach, two forms of nondebtor releases seem poised to pass this test: exculpation clauses and channeling injunctions.

Exculpation clauses are "commonplace provision[s]" designed to prevent future litigation over negligent acts that took place during the bankruptcy proceedings.[254] As such, typical exculpation clauses do not hamper the ability of creditors to recover on pre-petition claims. Prohibiting standard exculpation clauses may force the negotiating parties into overly litigious postures that could harm the reorganization effort. Moreover,

249. A prime example of this is the Sixth Circuit's seven-factor test established in *Class Five Nevada Claimants v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 658 (6th Cir. 2002). Another oft-cited test was laid out by a Missouri bankruptcy court in *In re Master Mortgage Investment Fund, Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994).

250. *See supra* note 247 and accompanying text.

251. Airadigm Commc'ns, Inc. v. FCC (*In re* Airadigm Commc'ns, Inc.), 519 F.3d 640, 657 (7th Cir. 2008).

252. SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (*In re* Seaside Eng'g & Surveying, Inc.), 780 F.3d 1070, 1079 (11th Cir. 2015).

253. *In re Dow Corning Corp.*, 280 F.3d at 658.

254. *In re* PWS Holding Corp., 228 F.3d 224, 245 (3d Cir. 2000).

exculpation clauses may prove essential to the plan, especially in the context of contentious, complex litigation.

In *Blixseth*, for example, the exculpation clause was crucial to the success of the reorganization. Credit Suisse's objection to its initial exclusion from the exculpation clause "threatened the confirmation of the plan"[255] and welcomed even more litigation into the already complicated legal saga of the Yellowstone Club which could have legitimately obstructed the Yellowstone Club's ability to restructure. Instead, CrossHarbor bought the Yellowstone Club, and, only six years after reorganizing, the company was "thriving" as it doubled its membership and sold nearly $1 billion in real estate in a two-year period.[256] The exculpation clause certainly was not the sole cause of the company's success, but its inclusion in the plan helped prevent liquidation and, to some extent, allowed the new owners to rejuvenate the business without distraction.

Of course, not all exculpation clauses are made equal. An exculpation clause releasing parties from liability for fraud, willful misconduct, or gross negligence, for example, would be hard to justify. Exculpation clauses are included in reorganization plans to lend finality to a reorganization and allow parties to negotiate efficiently without fear of subsequent litigation.[257] Insulating fraudulent behavior and intentional misconduct in the reorganization would undermine both of these goals. Under the *Energy Resources Co.* test, courts would likely find exculpation clauses releasing parties from such acts to be overly broad, unnecessary for the success of the reorganization, or otherwise not "appropriate."

Channeling injunctions will also usually be deemed "necessary" and "appropriate" under the *Energy Resources Co.* test. Such orders are appropriate because they provide full payment to the enjoined creditor; and in many cases, these nondebtor releases can be the "cornerstone" of a debtor's restructuring.[258] In *Menard-Sanford v. Mabey*, for example, "the entire reorganization hinge[d]" on the channeling injunction, as it shielded the debtor from burdensome contribution claims brought on by indirect attacks on the debtor's insurer.[259] At least in the mass tort context, few courts

255. Blixseth v. Credit Suisse, 961 F.3d 1074, 1078 (9th Cir. 2020), *cert. denied*, 141 S. Ct. 1394 (2021).

256. Sarah Max, *Huge Ski Resort for the Rich Is Bouncing Back*, N.Y. TIMES (Dec. 31, 2014, 9:00 AM), https://dealbook.nytimes.com/2014/12/31/huge-ski-resort-for-the-rich-is-bouncing-back/?_r=0 [https://perma.cc/G45V-42BJ].

257. *See* discussion *supra* Section I.C.3.

258. *See, e.g.*, Kane v. Johns-Manville Corp., 843 F.2d 636, 640 (2d Cir. 1988) (describing the settlement fund to which claims were channeled in Johns-Manville's reorganization as the "cornerstone" of the plan).

259. Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989)

doubt the importance of channeling injunctions to the debtor's reorganization.[260] Problems may arise, however, in terms of the fairness of the injunction to the enjoined creditors. The fundamental purpose of the channeling injunction is to shift claims away from nondebtors to a fund for compensation.[261] If there are findings indicating the fund is inadequate to fulfill this purpose, or that the channeling injunction flatly extinguishes some claims while channeling others, it may be deemed inappropriate.

Professor Ralph Brubaker, who has penned multiple articles articulating well-reasoned arguments against the use of nondebtor releases in Chapter 11 reorganizations, expresses serious concerns about channeling injunctions. Professor Brubaker argues they are "mechanism[s] that forcibly convert[] creditors' in personam claims against a non-debtor into in rem claims against the debtor's property . . . without any assurance that the substituted in rem rights against the debtor's property are the equivalent of the extinguished in personam rights."[262] His concern is undoubtedly valid when the nondebtor in question is not a co-obligor of the debtor. As noted by Professor Joshua M. Silverstein, in that situation, "payment in full is only possible where the creditor receives additional compensation beyond any plan distributions intended to satisfy its claims against the debtor."[263] On the other hand, where the nondebtor is a co-obligor of the debtor, "payment in full on a claim against a debtor eliminates the claimant's rights against any codebtor . . . through the prohibition on double recovery."[264]

Moreover, it is important to remember that bankruptcy courts are courts of equity, and they have broad powers to facilitate reorganization: the automatic stay, the ability to "cram-down" creditors, the unwinding of preferential transactions, and so on. Nondebtor releases are undoubtedly one of the more radical tools of bankruptcy courts. But when they are used to ensure payment for unsecured creditors, organize and expedite complex bankruptcy cases, and facilitate the debtor's reorganization effort, the benefits of the release will clearly outweigh its inequities and will almost certainly be approved under the *Energy Resources Co.* test.

(concluding A.H. Robins's reorganization depended on the corporation "being free from indirect claims such as suits against parties who would have indemnity or contribution claims against the debtor").

260. Their utility in asbestos-related mass tort claims was recognized by Congress, which sanctioned the use of channeling injunctions specifically asbestos-related incidents in § 524(g). *See also* Elizabeth Gamble, Note, *Nondebtor Releases in Chapter 11 Reorganizations: A Limited Power*, 38 FORDHAM URB. L.J. 821, 824 (2011) (noting "[t]he insurer's contribution to a claimant's trust can aid the debtor's reorganization because the debtor can avoid time-consuming litigation with the insurer over the scope of the insurance policy, the cost of which would deplete assets of the estate").

261. *See* discussion *supra* Section I.C.2.

262. Brubaker, *supra* note 2, at 1038.

263. Silverstein, *supra* note 5, at 25.

264. *Id.*

Finally, actual releases will present the closest questions under the *Energy Resources Co.* test. Actual releases will often present an efficient means of resolving a bankruptcy case at the expense of fairness to the enjoined creditors. Judges faced with actual releases should consider specific factual findings that demonstrate the release's fairness and necessity. While this Note does not endorse a factor-based test for the approval of nondebtor releases, courts should place primary emphasis on a few circumstances that could warrant the use of an actual release.

First and foremost, bankruptcy judges should consider whether the nondebtor is making any contributions to the reorganization effort, and, if so, whether those funds significantly decrease the likelihood of plan failure. Second, emphasis should be placed on the proportion of creditors that approve the plan. Any baseline approval rate will be inherently arbitrary. That said, under § 1126(c) of the Bankruptcy Code, a class of claims is said to accept a reorganization plan if creditors holding two-thirds in amount and more than one-half in number of allowed claims approve the plan.[265] Anything below that benchmark should conclusively defeat a nondebtor release. And courts that have approved actual releases have generally sought at least ninety percent approval from all creditors; anything more should weigh in favor of approval.[266] Between those two points, judges should exercise their discretion in evaluating the appropriateness and necessity of a plan. Other considerations might include whether some other important provision of the reorganization plan is contingent on the inclusion of a nondebtor release; the relatedness of creditors' claims against the nondebtor and debtor; the ability of the creditors to collect on a judgment in the absence of the nondebtor release; and the scope of the release. The list could extend well beyond what is presented here.

Ultimately, actual releases should be judged on a case-by-case basis with an eye towards the *Energy Resources Co.* test and the twin objectives of Chapter 11: "preserving going concerns and maximizing property available to satisfy creditors."[267] Admittedly, this provides bankruptcy courts with rather unclear guidelines. However, in the absence of congressional or Supreme Court intervention, analyzing actual releases under the *Energy Resources Co.* test is the best way to adhere to the text and spirit of the Bankruptcy Code while negating the potential for abuse inherent in actual releases.

265. 11 U.S.C. § 1126(c).

266. *See, e.g.*, Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 698 (4th Cir. 1989) (94.38% plan approval); *In re* Purdue Pharma L.P., No. 19-23649, 2021 WL 4240974, at *3 (Bankr. S.D.N.Y. Sept. 17, 2021) (more than 95% plan approval).

267. Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999).

In sum, bankruptcy courts should be empowered to use their discretion under the *Energy Resources Co.* test to determine when a nondebtor release is appropriate, necessary, and not inconsistent with the Code. This test contains sufficient safeguards to negate the potential for abuse in nondebtor releases while affording bankruptcy courts the flexibility to conduct a holistic assessment of the nondebtor release at issue to determine its validity.

CONCLUSION

This Note has argued that the Ninth Circuit in *Blixseth* abandoned the minority of jurisdictions—a minority it previously led—that prohibit the use of any and all nondebtor releases and joined the majority of jurisdictions that approve such releases in some circumstances. But this shift was incremental, permitting only one form of nondebtor release in a specific circumstance. The Bankruptcy Code and Supreme Court precedent, however, provide a framework for a more liberal position on nondebtor releases than that adopted by the Ninth Circuit in *Blixseth*. The Supreme Court's holding in *Energy Resources Co.* that bankruptcy court orders need only be necessary, appropriate, and not inconsistent with the Code establishes a framework for analyzing nondebtor releases that advances the Code's overarching goal of reorganization. As such, it would have been a better model for the Ninth Circuit to assume in *Blixseth*.