Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT® APRIL/MAY 2020

LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 16 **NUMBER 3** **April/May 2020**

LexisNexis®

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call:
Kent K. B. Hanson, J.D., at 415-908-3207
Email: ..... kent.hanson@lexisnexis.com
Outside the United States and Canada, please call . . . . . (973) 820-2000

For assistance with replacement pages, shipments, billing or other customer service matters, please call:
Customer Services Department at . . . . . (800) 833-9844
Outside the United States and Canada, please call . . . . . (518) 487-3385
Fax Number . . . . . (800) 828-8341
Customer Service Website . . . . . http://www.lexisnexis.com/custserv/

For information on other Matthew Bender publications, please call
Your account manager or . . . . . (800) 223-1940
Outside the United States and Canada, please call . . . . . (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)
ISBN: 978-0-7698-7988-8 (eBook)
ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT'S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the "Rescue and Recovery" Culture for Business Recovery*, 10 PRATT'S JOURNAL OF BANKRUPTCY LAW 349 (2014)

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW BENDER

(2020–Pub.4789)

Editor-in-Chief, Editor & Board of Editors

PRATT'S JOURNAL OF BANKRUPTCY LAW is published eight times a year by Matthew Bender & Company, Inc.

Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway, No. 18R, Floral Park, NY 11005, smeyerowitz@meyerowitzcommunications.com, 646.539.8300. Material for publication is welcomed—articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher. POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, Attn: Customer Service, 9443 Springboro Pike, Miamisburg, OH 45342-9907.

Third Circuit Holds Bankruptcy Courts May Constitutionally Confirm a Chapter 11 Plan Containing Nonconsensual Third-Party Releases

By Brian Trust, Adam C. Paul, Thomas S. Kiriakos, Sean T. Scott, and Alexander F. Berk*

The authors of this article discuss a notable U.S. Court of Appeals for the Third Circuit decision that bankruptcy courts have the constitutional authority, well within the constraints of Stern v. Marshall, *to confirm Chapter 11 reorganization plans containing nonconsensual third-party releases.*

The U.S. Court of Appeals for the Third Circuit held in *In re Millennium Lab Holdings II, LLC*[1] that bankruptcy courts have the constitutional authority, well within the constraints of *Stern v. Marshall*,[2] to confirm Chapter 11 reorganization plans containing nonconsensual third-party releases.

This decision is notable not only because it is the first federal circuit court of appeals decision addressing (and overruling) a *Stern* challenge to a bankruptcy court's authority to approve such releases but also because it was issued in a circuit where the ability of a plan to otherwise provide for nonconsensual releases of third-party claims is already generally recognized.[3]

---

* Brian Trust (btrust@mayerbrown.com), a partner at Mayer Brown LLP and co-leader of the Global Restructuring practice, handles complex restructuring matters. Adam C. Paul (apaul@mayerbrown.com), a partner at the firm and co-leader of its Global Restructuring practice, represents both debtor and creditor clients in complex U.S. and non-U.S. reorganizations and advises boards of directors and senior officers regarding fiduciary duties and restructuring strategies. Thomas S. Kiriakos (tkiriakos@mayerbrown.com) is a financial restructuring and bankruptcy partner and is the office practice leader for the Restructuring practice in the firm's Chicago office. Sean T. Scott (stscott@mayerbrown.com) is a partner at the firm and a member of the Restructuring practice, handling complex insolvency matters. Alexander F. Berk (aberk@mayerbrown.com) is an associate at the firm and a member of its Restructuring practice.

1 *In re Millennium Lab Holdings II, LLC* ("*Millennium Lab*"), 945 F.3d 126 (3d Cir. 2019).

2 *Stern v. Marshall*, 564 U.S. 462 (2011).

3 *Compare In re Continental Airlines, Inc.*, 203 F.3d 203, 214 (3d Cir. 2000) (nonconsensual third-party releases are permissible under certain circumstances) (*dictum*), *cited in Millennium Lab*, *supra* note 1, *with In re S.A.B. de CV*, 701 F.3d 1031, 1059; 1066–70 (5th Cir. 2012) (nonconsensual releases of third-party non-asbestos claims in bankruptcy cases have been "explicitly prohibited" in the circuit).

BACKGROUND

Millennium Lab Holdings II, LLC and certain of its affiliates (collectively, "Millennium") provided laboratory-based diagnostic services. Millennium's ability to bill and receive reimbursement from the Center for Medicare and Medicaid Services was a critical component of its business.

In 2012, the federal government opened investigations into potential violations of the False Claims Act and other federal laws by Millennium in connection with its billing practices.

While the investigations were ongoing, Millennium, in 2014, entered into a $1.825 billion credit agreement with a multi-lender syndicate, including various funds and accounts managed by Voya Alternative Assets Management LLC ("Voya"). The federal government's investigation was not disclosed to the lenders at the time of the 2014 financing, and approximately $1.3 billion of the loan proceeds were dividended to Millennium's shareholders.

The federal government's investigation culminated in adverse findings against Millennium. Millennium and the federal government subsequently agreed to a settlement that required Millennium to pay $256 million to the federal government (the "2015 Settlement").

However, Millennium lacked the liquidity to service its debt obligations under its loan agreement and meet its financial obligations under the 2015 Settlement.

Following negotiations, Millennium and an ad hoc group of lenders that did not include Voya entered into a restructuring support agreement (the "RSA") that outlined the manner in which Millennium, upon the receipt of requisite lender approval, would be allowed to pay the federal government and restructure its other debt outside of court. The funding for these payments was to be provided in large part by Millennium's principal shareholders and, in return therefor and as an express condition thereof, such shareholders would be the beneficiaries of releases of all claims, including of any third-party lender claims tied to the 2014 financing.

The out-of-court restructuring effort did not receive the requisite lender support, with Voya being the principal dissenting lender. In response, and as expressly provided in the RSA as the fall-back mechanism for implementing the restructuring, Millennium filed a bankruptcy petition in November of 2015 and sought confirmation of a prepackaged plan of reorganization (the "Plan"), which included broad releases (including of third-party claims) in favor of Millennium's shareholders, to be supported and reinforced by a bar order and an injunction prohibiting the pursuit of any released claims (the "Third-Party Releases").

Maintaining that it intended to assert RICO, fraud and related claims against certain of Millennium's shareholders tied to the 2014 financing, Voya voted against and objected to confirmation of the Plan. The bankruptcy court confirmed the Plan over Voya's objection.

THE INITIAL APPEAL

In its initial appeal to the district court following plan confirmation, Voya argued that, based on *Stern*, the bankruptcy court lacked constitutional authority to approve the Third-Party Releases in the Plan over its objection. The district court remanded the case to the bankruptcy court on that issue, with the bankruptcy court determining after remand that *Stern* was inapplicable to plan confirmation and that the propriety of the releases at issue would be "necessarily resolved in the confirmation process."

Voya again appealed to the district court, which affirmed the bankruptcy court, leading to Voya's appeal to the Third Circuit.

STERN V. MARSHALL

In *Stern*, the Supreme Court held that the bankruptcy court lacked the constitutional authority to enter a final judgment on a debtor's state law counterclaim for tortious interference of contract, concluding that "[w]hen a suit is made of the stuff of the traditional actions at common law tried by the courts at Westminster in 1789, and is brought within the bounds of federal jurisdiction, the responsibility for deciding that suit rests with Article III judges in Article III courts."[4]

In opposition, the debtor had argued in *Stern* that, because the creditor had filed a proof of claim, the bankruptcy court nonetheless had the constitutional authority to resolve the counterclaim as part of the allowance or disallowance of the proof of claim—that the resolution of such related claims were part and parcel of the bankruptcy claim resolution process and, thus, well within the constitutional authority of a bankruptcy court. In rejecting that argument, the Supreme Court observed that the question is not whether the subject action has "some bearing" on the bankruptcy case but "whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claim allowance process."[5]

---

[4] *Stern*, 564 U.S. at 484 (quoting *Northern Pipeline Construction Company v. Marathon Pipe Company*, 458 U.S. 50, 90 (1982) (Rehnquist, J., concurring in judgment) (internal quotation marks omitted)), quoted in *Millennium Lab*, *supra* note 1.

[5] *Stern*, 564 U.S. at 499, *quoted in Millennium Lab*, *supra* note 1.

IN THE THIRD CIRCUIT

Voya argued to the Third Circuit in *Millennium* that its alleged RICO/fraud claims against Millennium's shareholders and insiders did "not stem from the bankruptcy itself and would not be resolved in the claims-allowance process"[6] and thus could not be constitutionally resolved by a plan confirmation order and injunction issued by an Article I bankruptcy court but instead had to be heard by an Article III judge in an Article III court.

However, the Third Circuit, after setting forth its analysis of *Stern* and two pre-*Stern* Supreme Court decisions,[7] concluded that *Stern* can be read for the proposition that "a bankruptcy court is within its constitutional bounds when it resolves a matter that is integral to the restructuring of the debtor-creditor relationship,"[8] whether or not such matters arise in the claim allowance process. The Third Circuit then proceeded to affirm the bankruptcy court's findings and holding that the releases were integral to the restructuring of the debtor-creditor relationship.

Specifically, the Third Circuit stated that the releases were critical to the success of the Plan, as, without such releases, the required funding would not be provided and, without such required funding, Millennium would have lost its Medicare billing privileges (and, thus, its ability to continue as a going concern) and would not have been able to make the plan distributions, including the payment of the 2015 Settlement.[9]

Implicit in the court's holding is the conclusion that the resolution of claims against non-debtors—claims that are outside the scope of a bankruptcy discharge under Section 524 of the Bankruptcy Code—can be integral to the restructuring of the debtor-creditor relationship at issue for the purposes of conferring jurisdiction in the underlying bankruptcy case.

In responding to another argument made by Voya, the Third Circuit opined that its decision was not intended to open the "floodgates" to the limitless power of the bankruptcy court to approve releases "simply because reorganization financers demand them"[10] and that, in particular, the court was not "broadly sanctioning the permissibility of nonconsensual third-party releases in

---

[6] *Millennium Lab*, *supra* note 1.

[7] *Id.*(discussing *Katchen v. Landy*, 382 U.S. 323 (1966), and *Langenkamp v. Culp*, 498 U.S. 42 (1990)).

[8] *Id.*

[9] *Id.*

[10] *Id.*

bankruptcy reorganization plans," referencing the "exacting standards" that its precedents require be satisfied if nonconsensual third-party releases and injunctions are to be sanctioned by a bankruptcy court.[11]

CONCLUSION

As noted, the Third Circuit's decision in *Millennium Labs* is the first federal circuit court of appeals decision to hold that a bankruptcy court's confirmation of a plan of reorganization with nonconsensual third-party plan releases does not run afoul of *Stern*.

Given the significance of the Third Circuit (and Delaware in particular) with respect to bankruptcy decisional law, the decision is an important one because this area of the law as *Stern*-related issues with respect to other plans providing for such nonconsensual third-party releases continue to arise and be addressed by courts.[12]

---

[11] *Id.* (citing *In re Global Indus. Techs., Inc.*, 645 F.3d 201, 206 (3d Cir. 2011) (*en banc*); and *In re Continental Airlines, Inc.*, 203 F.3d 203, 214 (3d Cir. 2000)).

[12] Those issues also might implicate the other two Supreme Court decisions in the *Stern* trilogy, *Exec. Benefits Ins. Agency v. Arkison*, 573 U.S. 25 (2014) (*Stern* jurisdictional deficiency can be cured by *de novo* review of bankruptcy court's findings by an Article III judge), and *Wellness Int'l Network, Ltd. v. Sharif*, 135 S. Ct. 1932, 191 l. Ed. 2d 911 (2014) (possible *Stern* jurisdictional deficiency can be cured by consent, including consent implied based on the circumstances of the case). In *Millennium Lab*, the district court, as an alternative holding in the second intermediate appeal, essentially followed *Arkison* in undertaking a *de novo* review of the record and entering the same findings as the bankruptcy court. The Third Circuit, however, elected to address the *Stern* issue of the bankruptcy court's constitutional authority directly instead of affirming the district court's *de novo* findings and conclusion under *Arkison*.