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Expert Analysis

'Millennium Lab': the Death Knell For Non-Consensual, Third-Party Releases?

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One of the principal goals of Chapter 11 is to provide the debtor with a "fresh start" upon emergence. To accomplish this goal, the Bankruptcy Code provides a broad release and discharge of claims against the debtor. But this is not always enough to bring the case to a successful resolution. In exchange for contributing to the case, non-debtors often insist on receiving their own release of liability, not only from claims belonging to the debtor, but the claims of third-parties too. This second type of release is commonly referred to as a "non-debtor, third-party release."

One frequently litigated issue is whether a Chapter 11 plan can release a non-debtor's claims against a non-debtor, third-party absent the releasing party's consent. While courts differ on this issue, most of the decisions have focused on the court's subject matter jurisdiction and application of circuit precedent on the permissibility of non-debtor, third-party releases, often assuming, without deciding, that the court has constitutional authority to grant the release if warranted under the substantive case law. In *Opt-Out Lenders v. Millennium Lab Holdings II*, Civ. No. 16-110-LPS (D. Del. March 17, 2017), the District Court for the District of Delaware potentially upended this way of thinking, suggesting that in many cases, bankruptcy courts lack authority under Article III of the U.S. Constitution to enter a final order granting non-debtor, third-party releases, at least without the affected party's consent. The decision is also significant for its holding that de novo review of the bankruptcy court's order could not cure the problem, reasoning that there was no adjudication of the third-party's claims in the first place, leaving nothing of substance for the district court to review.

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Without constitutional authority to adjudicate the claims at issue, the court cannot release them, whether or not prior decisions allowed it. And at least under 'Millennium', the district court's de novo review cannot cure the problem.

Background

Prior to Chapter 11, Millennium Lab Holdings II and its affiliates were providers of laboratory-based diagnostic testing services, which derived significant revenues from Medicare and Medicaid reimbursements. The Department of Justice

(DOJ) launched an investigation into the company's billing practices and eventually decided to take action, alleging Medicare fraud. Not long after, the Center for Medicare and Medicaid Services (CMS) notified Millennium that it was revoking the company's Medicare billing privileges on account of the alleged fraud.

Millennium reached an agreement in principle with the DOJ, CMS, and other government agencies to settle these claims in exchange for a payment of approximately $250 million. The company then disclosed the agreement to its lenders and asked to restructure its debt. Several months later, Millennium and a group of the lenders reached agreement on the terms of a restructuring, and the company filed prepackaged Chapter 11 cases to implement it. The crux of the Millennium Debtors' Chapter 11 plan was the agreement of the company's non-debtor shareholders to contribute $325 million to fund the DOJ settlement and pay those lenders who consented to the deal. In exchange, the plan provided a broad release in favor of the non-debtor shareholders, including the release of claims held by other non-debtor, third-parties. The plan provided no ability for parties to "opt-out" of the releases.

Before confirmation of the plan, a group of dissenting lenders filed a complaint in the bankruptcy court against the non-debtor shareholders and two company executives who were the beneficiaries of the proposed releases. The dissenting lenders asserted claims of common law fraud, i.e., alleging the defendants mislead them about the company's health and compliance with laws, while failing to disclose the DOJ investigation, as well as RICO and restitution claims.

The dissenting lenders then objected to confirmation, asserting that the plan could not release their claims against the non-debtor defendants. While the lenders raised a litany of arguments, the thrust was that the court lacked subject matter jurisdiction and could not approve the releases without consent of the affected parties. The briefs filed by the dissenting lenders raised but "did no more than touch upon" whether the bankruptcy court had adjudicatory authority over the claims under Article III of the U.S. Constitution and the U.S. Supreme Court's decision in *Stern v. Marshall*. 564 U.S. 462 (2011).

The bankruptcy court overruled the dissenting lenders' objection and confirmed the plan. The bankruptcy court found that it had "related to" subject matter jurisdiction, but did not address whether it had constitutional authority to approve the release. Assuming that it had jurisdiction, the bankruptcy court turned to whether the releases satisfied *In re Continental Airlines*, in which the Third Circuit denied the debtors' requested releases, but suggested that non-consensual, third-party releases may be permissible in some cases, outlining three "hallmarks" that would support a release—"fairness, necessity to the reorganization, and specific fact findings to support these conclusions … ." 203 F.3d 203 (3d Cir. 2000). The bankruptcy court found that the releases at issue met these hallmarks, reasoning that they were "fair and necessary to the reorganization" because the shareholders would not have contributed the $325 million without them, causing the plan settlements to fall apart. By approving the releases over the dissenting lenders' objection, the bankruptcy court broke with *In re Washington Mutual*, 442 B.R. 314 (Bankr. D. Del. 2011), where another Delaware bankruptcy judge found that despite *Continental* leaving the door ajar, non-debtor, third-party releases cannot be approved without the affected party's consent (whether by contract or the mechanism of voting in favor of the plan).

The dissenting lenders appealed.

Discussion

The dissenting lenders raised several issues on appeal, but refocused their argument on the bankruptcy court's lack of constitutional authority to release the claims. Millennium filed a motion to dismiss the appeal as equitably moot, arguing that notwithstanding any supposed merits, the plan was substantially consummated and the appeal would unscramble

it, thus violating the parties' expectation of finality. The dissenting lenders countered that it would be improper to dismiss the appeal as equitably moot without first deciding whether the bankruptcy court had constitutional authority to act. The district court agreed with the dissenting lenders, finding that it could not consider the motion to dismiss "without first determining whether a constitutional defect … deprived [the bankruptcy court] of the power to issue [the] decision."

The district court ultimately denied Millennium's motion to dismiss and remanded on the question of constitutional authority, finding that the bankruptcy court should have a chance to revisit that issue, since the parties failed to sufficiently address it below. While the district court could have ended there, it proceeded to assess the strengths and weakness of the parties' positions, observing that the dissenting lenders had the better of the argument. The district court found that the dissenting lenders "appear to be entitled to Article III adjudication of [their] claims" under *Stern*, reasoning that the claims at issue did not involve matters of "public rights" which could be assigned to a non-Article III judge, but rather were claims "between two private parties based on state common law or statutes that are not closely intertwined with a federal regulatory program." Thus, under *Stern* and the Supreme Court's subsequent decision in *Wellness Int'l Network v. Sharif*, 135 S. Ct. 1932 (2015), "no final order could be entered on such claims by an Article I court, barring consent of the parties…." The district court also rejected Millennium's argument that *Stern* was inapplicable because the releases did not adjudicate any claims, reasoning that the "release, which permanently extinguished [the lenders'] claims, is tantamount to resolution of those claims on the merits against [the lenders]."

Finally, the district court declined to adopt Millennium's suggestion that any constitutional infirmities could be "cured and mooted" through de novo review, reasoning that the bankruptcy court did not adjudicate the merits of the claims, but rather simply extinguished them, leaving nothing of substance for the district court to review.

Implications

While not a binding precedent, the decision is significant for a few reasons.

First, while parties before the Delaware bankruptcy court could structure around *Millennium* by requiring consent of the affected party, which in practice would bring the non-debtor, third-party release in compliance with the earlier *Washington Mutual* standard, the district court's decision could affect future venue decisions where the parties seek non-consensual releases. This is because other courts—namely, the Bankruptcy Courts for the Southern District of New York and District of Massachusetts—have rejected *Stern* challenges in this context. See *In re MPM Silicones*, 2014 WL 4436335 (Bankr. S.D.N.Y. Sept. 9, 2014); *In re Charles Street African Methodist Episcopal Church of Boston*, 499 B.R. 66 (Bankr. D. Mass 2013). Thus, to the extent more than one venue option is available, debtors may rethink their venue choices.

Second, for those courts that allow non-consensual, third-party releases, but where the precedent precedes *Stern* or the court has not faced a similar challenge, *Millennium* potentially casts doubt on the continued validly of that precedent. Simply put, without constitutional authority to adjudicate the claims at issue, the court cannot release them, whether or not prior decisions allowed it. And at least under *Millennium*, the district court's de novo review cannot cure the problem.

Finally, while the extent to which *Millennium* catches on remains to be seen, for the time being, dissenting creditors and other parties may be more likely to challenge the propriety of non-debtor, third-party releases, citing the decision for support.

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