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Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate Over Non-Debtor Releases in Chapter 11 Reorganizations

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ARTICLES

HIDING IN PLAIN VIEW: A NEGLECTED SUPREME COURT DECISION RESOLVES THE DEBATE OVER NON-DEBTOR RELEASES IN CHAPTER 11 REORGANIZATIONS

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ABSTRACT

This Article presents a novel resolution of a long-standing circuit split on an issue of critical significance to bankruptcy and tort law: whether bankruptcy courts may extinguish liabilities of parties that have not filed for bankruptcy. Such "non-debtor releases" are similar in effect to a bankruptcy discharge and have become particularly common in both mass tort disputes and general insolvencies adjudicated through the bankruptcy process. In this Article, I illustrate how an overlooked Supreme Court decision—United States v. Energy Resources, 495 U.S. 545 (1990)—offers crucial support for the pro-release position. *Energy Resources* demonstrates that the bankruptcy courts' "general equitable power" allows them to extinguish claims against non-debtors and that such relief is not forbidden by any specific provision in the Bankruptcy Code.

INTRODUCTION

The ultimate policy of chapter 11[1] of the Bankruptcy Code[2] ("the Code") is the successful reorganization of debtors.[3] A successful reorganization is one that both rehabilitates the debtor and minimizes creditor forfeitures.[4] These two aims, while frequently in conflict,[5] are promoted by the Code's complex array of provisions—provisions that carefully balance the interests of debtors and creditors.[6]

In addition to its specific directives, the Code entrusts bankruptcy courts with "broad equitable powers to balance the interests of the affected parties, guided by the overriding goal of ensuring the success of the reorganization."[7] This equitable authority emanates primarily from § 105(a),[8] which states that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[9] Another source of general equitable power is § 1123(b)(6),[10] which permits a chapter 11 plan to

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1 11 U.S.C. §§ 1101-74 (2000).

2 §§ 101-1330. A fifteenth chapter was added to title 11 as part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 801(a), 119 Stat. 25, 134–35 (11 U.S.C. §§ 1501-1532) ("2005 Act"). None of the changes to the Bankruptcy Code set forth in the 2005 Act are pertinent to the issues discussed in this Article.

3 Pioneer Inv. Serv. Co. v. Brunswick Assoc. Ltd. P'ship, 507 U.S. 380, 389 (1993); NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984).

4 *Pioneer Inv. Serv.*, 507 U.S. at 389.

5 *See* Energy Res. Co. v. IRS (*In re* Energy Res. Co.), 871 F.2d 223, 230 (1st Cir. 1989) (observing that the Bankruptcy Code's twin purposes—"ensure fair payment to creditors and provide the bankrupt firm with an opportunity to make a 'fresh start'"—are "often conflicting"), *aff'd*, 495 U.S. 545 (1990).

6 *See In re* Whitfield, 290 B.R. 302, 306 (Bankr. E.D. Mich. 2003) ("The Bankruptcy Code reflects a careful balance of debtors' rights and creditors' remedies."); *In re* Cason, 190 B.R. 917, 927 (Bankr. N.D. Ala. 1995) ("The Bankruptcy Code as originally enacted carefully balanced creditors' property rights and debtors' fresh start.").

7 *Pioneer Inv. Serv.*, 507 U.S. at 389.

8 *See* Johnson v. Home State Bank, 501 U.S. 78, 88 (1991) ("In addition, the bankruptcy court retains its broad equitable power to 'issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Code.]'") (quoting § 105(a); Architectural Bldg. Components v. McClarty (*In re* Foremost Mfg. Co.), 137 F.3d 919 (6th Cir. 1998) ("[T]he bankruptcy court has broad equitable powers under 11 U.S.C. § 105(a) . . . ."); Smith v. Omni Mfg., Inc. (*In re* Smith), 21 F.3d 660, 665 (5th Cir. 1994) ("From . . . section [105] emanate the general equitable powers of bankruptcy courts."); *In re* G.S.F. Corp., 938 F.2d 1467, 1474 (1st Cir. 1991) (observing that § 105(a) grants bankruptcy courts broad equitable powers); 2 COLLIER ON BANKRUPTCY ¶ 105.01, at 105-5 to 105-6 (Lawrence P. King ed., 15th ed. rev. 2004) ("Section 105(a) . . . is an omnibus provision phrased in such general terms as to be the basis for a broad exercise of power in the administration of a bankruptcy case.").

9 11 U.S.C. § 105(a) (2000).

10 United States v. Energy Res. Co., 495 U.S. 545, 549 (1990); United States v. Prescription Home Health Care, Inc. (*In re* Prescription Home Health Care, Inc.), 316 F.3d 542, 549 (5th Cir. 2002) ("*Energy*

"include any other appropriate provision not inconsistent with the applicable provisions of this title."[11] There is substantial disagreement over the scope of the authority conferred by these statutes.[12] And the controversy is particularly acute in the context of "non-debtor releases."[13]

A key component of debtor rehabilitation is the "fresh start" provided by chapter 11's discharge provision. Under § 1141(d)(1), the confirmation of a plan of reorganization discharges the bankrupt party from all of its preconfirmation debts (with limited exceptions).[14] The debtor emerges from bankruptcy with only the obligations set forth in its plan.[15] The plan also is binding on all of the debtor's creditors, including those that objected to its approval.[16] Pursuant to § 524 of the Code, the discharge benefits the debtor alone; the liabilities of guarantors, sureties, joint tort-feasors, shareholders, directors, employees, and related companies are not impacted.[17] Creditors thus generally are free to collect any deficiencies in bankruptcy payments from coliable parties and pursue independent claims against insiders and affiliated entities.[18] However, this is not always so. While the discharge itself does not shield third parties, a substantial number of bankruptcy courts have used the general equitable powers conferred by the Code to extinguish claims against non-debtors—i.e., to grant "non-debtor" or "third-party" releases.[19]

Resources recognized the broad equitable powers accorded bankruptcy courts under 11 U.S.C. § 105(a) and 1123(b)(6).").

11 § 1123(b)(6).

12 *See* 2 COLLIER ON BANKRUPTCY ¶ 105.01[2], at 105–8 (Lawrence P. King ed., 15th ed. rev. 2004) ("As might be expected with a general grant of power such as section 105, the specific line drawing of the boundaries of that power are not always clear."); *infra* Part II.A.

13 *See* discussion *infra* Part III.

14 § 1141(d)(1)-(3). Under the recent amendment to the Code, individual debtors—i.e., natural persons—are generally not entitled to a discharge until they complete all payments under their plan of reorganization. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 321(d)(2), 119 Stat. 95 (adding material to be codified at 11 U.S.C. § 1141(d)(5)(A)—(B)); *id.* at § 330(b), 119 Stat. 101 (adding material to be codified at 11 U.S.C. § 1141(d)(5)(C)). And new exceptions to a corporate debtor's discharge were instituted. *See id.* at § 708, 119 Stat. 126 (adding material to be codified at 11 U.S.C. § 1141(d)(6)).

15 § 1141(a).

16 *Id.*

17 *See* § 524(a), (e). There is one exception contained in § 524(a)(3), but it is not relevant to the issues addressed in this Article.

18 *In re* Transit Group, Inc., 286 B.R. 811, 815 (Bankr. M.D. Fla. 2002).

19 *See infra* Part III.B. The terms "non-debtor release" and "third-party release" are used interchangeably in this Article.

For at least eighteen years, the federal courts have been divided over whether such releases are permissible.[20] The Code does not expressly sanction the issuance of non-debtor releases.[21] However, "pro-release" courts contend that the equitable powers flowing from §§ 105(a) and 1123(b)(6) allow for this type of relief.[22] And they see no explicit prohibition on releases in the Code or elsewhere.[23] "Anti-release" courts, as their label suggests, disagree. Many "anti-release" courts have concluded that non-debtor releases run afoul of § 524(e), which 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."[24] They read this language, and the bankruptcy policies underlying it, to prohibit third-party releases.[25] Other anti-release courts do not believe that § 524(e) constitutes a bar. Instead, they think that §§ 105(a) and 1123(b)(6) simply do not grant sufficient equitable power to permit the release of claims against non-debtors.[26]

Commentators are also deeply split on the propriety of non-debtor releases. They have produced numerous articles defending a variety of pro-release and anti-release positions.[27]

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20 *Compare* Hat-Hanseatische Anlage v. Sago Palms Joint Venture (*In re* Sago Palms Joint Venture), 39 B.R. 9, 9 (Bankr. S.D. Fla. 1984) (holding that § 524(e) bars non-debtor releases), *with In re* A.H. Robins Co., 88 B.R. 742, 754–55 (E.D. Va. 1988) (holding that courts may grant non-debtor releases pursuant to their "equitable and inherent" power under the Bankruptcy Code), *aff'd*, 880 F.2d 694 (4th Cir. 1989).

21 Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 656 (6th Cir. 2002) ("The Bankruptcy Code does not explicitly prohibit or authorize a bankruptcy court to enjoin a non-consenting creditor's claims against a non-debtor to facilitate a reorganization plan."). There is one exception in the Code for asbestos cases. *See generally* § 524(g) (setting forth an elaborate procedure for obtaining non-debtor releases in the asbestos context).

22 *See infra* notes 275–76 and accompanying text. These courts typically mandate that third-party releases satisfy stringent requirements. *See infra* notes 284–304 and accompanying text.

23 *See infra* notes 277–83 and accompanying text.

24 § 524(e).

25 *See infra* notes 165–204 and accompanying text.

26 *See infra* notes 205–13 and accompanying text; Part III.C.

27 For commentators adopting a "pro-release" view, see Howard C. Buschman III & Sean P. Madden, *The Power and the Propriety of Bankruptcy Court Intervention in Actions Between Nondebtors*, 47 BUS. LAW. 913, 940–42 (1992) [hereinafter Buschman] (arguing that non-debtor releases are permissible in certain circumstances); Kate Inman, Note, *All Debts Are Off?—Can the Bankruptcy Process Be Used to Release the Debts of Nondebtor Parties*, 49 FLA. L. REV. 631, 648–49 (1997) (concluding that "the pro-release approach . . . is the better reasoned approach," because, *inter alia*, § 524(e) does not expressly bar non-debtor releases). Some commentators approve of non-debtor releases, but only in fairly narrow circumstances. *See* Hydee R. Feldstein, *Reinterpreting Bankruptcy Code § 524(e): The Validity of Third-Party Releases in a Plan*, 22 CAL. BANKR. J. 25, 26–27, 39, 45 (1994) (concluding that "non-debtor releases" are permissible under §§ 105(a) and 1123(b)(6), but referring largely to the discharge of *derivative* claims that are actually property of the estate); John E. Swallow, Note, *The Power of the Shield—Permanently Enjoining Litigation Against Entities Other than the Debtor—A Look at* In re A.H. Robins Co., 1990 BYU L. REV. 707, 709 (1990) (arguing

If anything is clear, it is that non-debtor releases are receiving "growing judicial acceptance" and are becoming increasingly common in chapter 11 plans of reorganization.[28] Indeed, one commentator has suggested that "the practice of approving non-debtor releases is more widespread than the number of published judicial opinions would suggest[,]" because appellate challenges to plans of reorganization are often mooted by consummation of the plan.[29] And whereas in 2005 the number of corporate bankruptcies finally began falling from record levels,[30] the recent scandals rocking Wall Street and the

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that non-debtor releases are permissible under § 1123(b)(6) (which, at the time, was set forth at § 1123(b)(5)) where (1) the plan provides payment in full on all extinguished claims, (2) the non-debtor release is essential to the plan, and (3) a substantial majority of creditors support the plan); Kenneth M. Lewis, *When are Nondebtors Really Entitled to a Discharge: Setting the Record Straight on* Johns-Manville *and* A.H. Robins, 3 J. BANKR. LAW AND PRAC. 163, 176 (1994) (asserting that § 524(e) bars non-debtor releases except (1) where creditors receive payment in full under the plan for any extinguished claims, and (2) in certain partnership contexts); Helen H. Han, Note, *Testing the Limits of Judicial Discretion in Chapter 11: The Doctrine of Necessity and Third Party Releases*, 1994 ANN. SURV. AM. L. 551, 554, 579 (1995) (asserting that bankruptcy courts may grant non-debtor releases under § 105(a) only where any released claims are paid in full under the plan); Peter E. Meltzer, *Getting Out of Jail Free: Can the Bankruptcy Plan Process Be Used to Release Nondebtor Parties?*, 71 AM. BANKR. L.J. 1, 41 (1997) (concluding that bankruptcy courts have insufficient power under § 105(a) to grant non-debtor releases unless the plan provides for payment in full on the extinguished claims immediately upon confirmation of the plan of reorganization). Finally, others believe that non-debtor releases violate the Code. *See* Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959 (1997) (concluding that non-debtor releases are inconsistent with numerous provisions of the Bankruptcy Code and are thus invalid); Judith R. Starr, *Bankruptcy Court Jurisdiction to Release Insiders from Creditor Claims in Corporate Reorganizations*, 9 BANKR. DEV. J. 485, 487 (1993) (arguing that § 524(e) prohibits non-debtor releases); Peter M. Boyle, Note, *Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy*, 61 FORDHAM L. REV. 421, 422, 436 (1992) (same).

28 Brubaker, *supra* note 27, at 961; *accord In re* Transit Group, Inc., 286 B.R. 811, 815 (Bankr. M.D. Fla. 2002) ("In the last few years, debtors more frequently are seeking to expand the scope of the discharge to include the release of claims against non-debtor third-parties and insiders."); Buschman, *supra* note 27, at 943 (noting "a trend among debtors to provide releases for nondebtors in reorganization plans"); Meltzer, *supra* note 27, at 1 (observing that "the custom of attempting to include releases of nondebtor parties has become more and more prevalent"); Han, *supra* note 27, at 565-66 ("an increasing number of nondebtors seek and are granted release from, or injunctions against, liability under the broad equitable powers granted by section 105(a)"); Inman, *supra* note 27, at 632 ("[M]any reorganization plans contain release provisions which purport to permanently discharge the liability of other parties such as the bankrupt entity's insiders, partners, plan funders, or other individuals or entities . . . .").

29 Brubaker, *supra* note 27, at 964 n.15. *See, e.g.*, Deutsche Bank AG v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 143–45 (2d Cir. 2005) (ruling that the third-party release contained in the debtor's plan of reorganization was invalid, but that the appeal was mooted by consummation of the plan).

30 *See* Dena Aubin, *Business failures surge to record*, CHI. TRIB., Dec. 21, 2002, § 3, at 1, 4, 2002 WLNR 12678130 ("U.S. public companies have shattered bankruptcy records for a second straight year as accounting fraud and the last decade's debt spree brought down corporate giants, and experts are bracing for more such woes."); *Continued increase in filings for bankruptcy*, CHI. TRIB., Nov. 15, 2003, § 2, at 1, 2, 2003 WLNR 15297516 (noting that the number of bankruptcy filings by businesses decreased in fiscal year 2003,

broader American business community are giving rise to precisely the type of mass-tort disputes that have inspired courts to approve of non-debtor releases in the past.[31]

The propriety of third-party releases is thus an issue that cries out for Supreme Court guidance,[32] particularly since "the bankruptcy court is quickly becoming the forum for resolution of many of the largest and most complex mass litigations."[33] If the High Court does join the fray, there is a largely overlooked decision from which the Justices should seek guidance—the Court's own ruling in *United States v. Energy Resources Co.* ("*Energy*

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but remained near record levels); *Bankruptcies Filed in FY '04 Still High But Down From Levels Posted in FY '03*, 73 U.S.L.Wk. 2341, 2342 (Dec. 14, 2004) (Vol. 73, No. 22) (observing that fiscal year 2004 chapter 11 filings were up 2.2% from fiscal year 2003); Patricia Manson, *Bankruptcy Filings Drop in Wake of Code Rewrite*, CHI. DAILY LAW BULL., Mar. 24, 2006, § 1, at 24 ("Filings under Chapter 11 . . . registered a 33 percent decline in 2005 from 2004.").

[31] *See, e.g.*, SEC v. Drexel Burnham Lambert, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 130 B.R. 910, 918–19 (S.D.N.Y. 1991) (this bankruptcy involved "tens of thousands" of persons with claims against the debtors for securities violations; the plan contained a non-debtor release extinguishing claims against the debtors' officers, directors, and others), *aff'd*, 960 F.2d 285 (2d Cir. 1992); *In re* A.H. Robins Co., 88 B.R. 742, 743–44, 754–55 (E.D. Va. 1988) (indicating that A.H. Robins was forced into bankruptcy because of thousands of tort actions relating to its Dalkon Shield contraceptive device; the company's plan of reorganization contained a non-debtor release extinguishing all claims the injured tort claimants possessed against several third parties), *aff'd*, 880 F.2d 694 (4th Cir. 1989); *see also* Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 213 (3d Cir. 2000) (observing that circuit courts adopting a "flexible approach" to non-debtor releases did so "in the context of extraordinary cases"); *In re* Digital Impact, Inc., 223 B.R. 1, 9 (N.D. Okla. 1998) ("The seminal cases under the Bankruptcy Code concerning confirmation of plans that include provisions enjoining creditors from pursuing claims against non-debtor third parties were bankruptcies resulting from mass tort litigation concerning defective products."); *In re* Seatco, Inc., 257 B.R. 469, 473 (Bankr. N.D. Tex. 2001) (observing that non-debtor releases have been affirmed "principally in large, complex, mass tort-type bankruptcy cases"). *See generally* Duane Loft, Note, *Jurisdictional Line-Drawing in a Time When So Much Litigation is "Related To" Bankruptcy: A Practical and Constitutional Solution*, 72 FORDHAM. L. REV. 1091, 1091 (2004) ("The past five years have seen some of the largest bankruptcies in history—WorldCom, Enron, Federal-Mogul, just to name a few. Collapsing into bankruptcy amid allegations of fraud or mass tort, these companies precipitated waves of litigation in state courts across America.") (footnotes omitted); *accord* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L. J. 1521, 1545 (2005) ("[T]he Enron scandal was followed by revelations of accounting fraud and insider self-dealing at several large corporations, nearly all of which were thereafter pushed into bankruptcy: Adelphia Communications, Global Crossing, Tyco International, and WorldCom.").

[32] *See* Inman, *supra* note 27, at 631 (observing that the propriety of non-debtor releases is "attractive" for Supreme Court review because of the split in the circuits); Meltzer, *supra* note 27, at 2 ("The issue [of non-debtor releases] may attract the attention of the Supreme Court in view of the split in the circuits and the attention of Congress in connection with its ongoing review of the Bankruptcy Code."); *see also* NAT'L BANKR. REVIEW. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 535 (1997) ("Current law offers little guidance to the parties and the courts on whether nondebtor release provisions may be included in a settlement or plan of reorganization and subsequently enforced by an injunction.").

[33] Brubaker, *supra* note 27, at 965.

Resources").[34] *Energy Resources* held that bankruptcy courts may use their equitable powers under §§ 105(a) and 1123(b)(6) to compel the Internal Revenue Service ("IRS") to allocate a chapter 11 debtor's tax payments to those tax liabilities chosen by the debtor.[35] In this Article, I argue that the Supreme Court's holding and rationale in *Energy Resources* demonstrate that the pro-release courts and commentators have the better view of §§ 105(a), 1123(b)(6), and 524(e).[36] I thus conclude that bankruptcy courts have the power to issue non-debtor releases,[37] though only in fairly narrow circumstances.[38]

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[34] 495 U.S. 545 (1990).

[35] *Id.* at 548–49.

[36] *See infra* Part V.

[37] *Id.*

[38] *See infra* Part III.B.4. This Article does *not* address whether bankruptcy courts have *subject matter jurisdiction* over claims that are extinguished by non-debtor releases. *See generally* 28 U.S.C. § 1334(a) & (b) (2000) (granting subject matter jurisdiction in bankruptcy matters to federal district courts); § 157(a) (permitting bankruptcy matters to be referred to bankruptcy courts). The focus here is only on the bankruptcy courts' *power* to issue third-party releases once jurisdiction is established. *See generally* Inman, *supra* note 27, at 633 n.6 ("This Note focuses on the bankruptcy courts' power to issue permanent injunctions rather than jurisdiction issues."); Wasserman v. Immormino (*In re* Granger Garage, Inc.), 921 F.2d 74, 77 (6th Cir. 1990) (§ 105(a) is not a jurisdictional provision).

A number of courts have confused the concepts of jurisdiction and power. *See, e.g.*, Seaport Automotive Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts, Inc.), 113 B.R. 610, 615 (B.A.P. 9th Cir. 1990) (mistakenly claiming that the Ninth Circuit held in Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 624–25 (9th Cir. 1989), that bankruptcy courts lack subject matter jurisdiction to grant non-debtor releases when in reality the Ninth Circuit held that bankruptcy courts do not have the power to provide such relief). The difference must therefore be kept in mind. Ironically, the Ninth Circuit explained the distinction quite cogently in *American Hardwoods*:

> Subject matter jurisdiction and power are separate prerequisites to the court's capacity to act. Subject matter jurisdiction is the court's authority to entertain an action between the parties before it. Power under section 105 is the scope and forms of relief the court may order in an action in which it has jurisdiction.

Am. Hardwoods, 885 F.2d at 624; *see also In re* Arrowmill Dev. Corp., 211 B.R. 497, 504 (E.D. Pa. 1989) ("Consequently, while a bankruptcy court may have subject matter jurisdiction to hear a dispute between nondebtors, it may lack the statutory authority to enter a particular type of relief, such as a nondebtor discharge."); *accord In re* Dow Corning Corp., 255 B.R. 445, 476 (E.D. Mich. 2000), *rev'd on other grounds*, 280 F.3d 648 (6th Cir. 2002); Buschman, *supra* note 27, at 921; Meltzer, *supra* note 27, at 13.

A bankruptcy court's jurisdiction over disputes between non-debtors, the type involving claims extinguished by third-party releases, flows from its "related to jurisdiction." *See* § 1334(b) (providing that federal district courts have jurisdiction "of all civil proceedings arising under title 11, or arising in or *related to* cases under title 11") (emphasis added); § 157(a) (permitting "any or all" bankruptcy matters to be referred to bankruptcy courts); Celotex Corp. v. Edwards, 514 U.S. 300, 308 n.5 (1995) ("Proceedings 'related to' the bankruptcy include . . . suits between third parties which have an effect on the bankruptcy estate."). The Third Circuit set forth the generally-accepted test for "related to jurisdiction" in Pacor, Inc. v. Higgins, 743 F.2d 984 (3d Cir. 1984). *See* 1 COLLIER ON BANKRUPTCY ¶ 3.01[4][c][ii][B], at 3-25 to 3-36 & n.85 (Lawrence P. King ed., 15th ed. rev. 2004). Explaining that "Congress intended to grant comprehensive jurisdiction to the

Part I of this Article sets forth a brief taxonomy of non-debtor releases. Part II provides general background on the Code provisions that are central to the validity of such releases. Then, Part III surveys the split in the courts, outlining both the pro-release and anti-release lines of authority. It also presents some important arguments raised by commentators.

Part IV contains a thorough recitation of *Energy Resources*. In addition to discussing the holding and rationale of the Supreme Court, this Part sets forth background information on the relevant tax laws and synopses of (1) the underlying bankruptcy, district, and circuit court decisions and (2) the briefs filed in the Supreme Court. The summaries of the lower court opinions and the

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bankruptcy courts," the Third Circuit held that those courts have "related to jurisdiction" over all claims that "could conceivably have any effect on the estate being administered in bankruptcy." *Pacor*, 743 F.2d at 994. The federal courts of appeal have interpreted this standard in disparate ways. Buschman, *supra* note 27, at 927–28 (collecting authorities); 1 COLLIER ¶ 3.01[4][c][ii][B], at 3-25 to 3-36 & n.85. That disagreement is beyond the scope of this Article.

Nonetheless, it should be noted that many anti-release courts—anti-release in terms of bankruptcy *power*—found *jurisdiction* over claims extinguished by third-party releases they ultimately struck down. *See, e.g.*, *Am. Hardwoods*, 885 F.2d at 624 (holding that the bankruptcy court had jurisdiction over a creditor's claims against the shareholder-guarantors of the debtor because execution of the creditor's judgment would deprive the shareholder-guarantors of any incentive to continue running the debtor, which "could conceivably" affect the administration of the debtor's estate) (internal quotation marks omitted); Arrowmill Dev. Corp., 211 B.R. at 502–03 (finding jurisdiction over a creditor's claim against the debtor's shareholder where the shareholder made a financial contribution to the estate as part of the plan of reorganization). *See also Celotex*, 514 U.S. at 309–10 (holding that the bankruptcy court had "related to jurisdiction" to temporarily bar judgment creditors of the debtor from attempting to execute against the debtor's sureties—several insurance companies—where (1) such executions would have destroyed any possibility that the debtor and its sureties could settle related insurance coverage disputes, and (2) such a settlement was essential to the formulation of a feasible plan of reorganization) (noting that this conclusion was consistent with court of appeals decisions finding jurisdiction over non-debtor disputes in several cases involving third-party releases) (citing *Am. Hardwoods*, 885 F.2d at 623, and Oberg v. Aetna Cas. & Sur. Co. (*In re* A.H. Robins Co.), 828 F.2d 1023, 1024–26 (4th Cir. 1987)); Inman*, supra* note 27, at 633 n.6 ("It is usually easy to establish jurisdiction [over non-debtor disputes] because bankruptcy courts have jurisdiction over all actions that could have any conceivable effect on the bankruptcy estate."). *But see In re* Digital Impact, Inc., 223 B.R. 1, 12–14 (N.D. Okla. 1998) (holding that bankruptcy courts do not have subject matter jurisdiction to issue non-debtor releases, even where the third-party contributes assets for distribution to creditors as part of the plan, because any litigation against the non-debtor after confirmation cannot affect the estate); *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 67 (Bankr. W.D. Pa. 1994) ("[W]e know of nothing which gives the bankruptcy court jurisdiction to adjudicate claims between two non-debtor third parties."); Brubaker, *supra* note 27, at 1033–80 (offering a sustained, multifaceted argument that bankruptcy courts do not have subject matter jurisdiction to issue non-debtor releases); Brubaker, *Nondebtor Releases and Injunctions in Chapter 11: Revising Jurisdictional Precepts and the Forgotten* Calloway v. Benton *Case*, 72 AM. BANKR. L. J. 1 (1998) (same). S*ee generally* Robert B. Chapman, *Bankruptcy: Eleventh Circuit Survey*, 53 MERCER L. REV. 1199, 1251 (2002) (suggesting that the *Pacor* test extends the bankruptcy court's "related to" jurisdiction beyond the constitutional boundaries of federal judicial power set by Article III).

Supreme Court briefs are included because they help illustrate the significance of *Energy Resources* to the non-debtor release debate.

Part V contains the main argument of this Article. In it, I assert that *Energy Resources* provides compelling support for the legitimacy of non-debtor releases. Finally, the Conclusion offers some closing thoughts.

I. A TAXONOMY OF NON-DEBTOR RELEASES

While there are several types of non-debtor releases, courts are not always careful to distinguish them.[39] Thus, this Part contains a brief taxonomy of third-party releases.

A. *Involuntary Non-Debtor Releases of Direct Claims*

The focus of this Article is non-debtor releases that extinguish a creditor's *direct* claims against a non-debtor *over the creditor's objection*—i.e., involuntary non-debtor releases of direct claims. Such releases come in various forms. First, a debtor's chapter 11 plan of reorganization may contain a section providing that certain claims against third parties are released.[40] Second, a bankruptcy court might permanently enjoin a creditor from prosecuting its claims against a non-debtor.[41] Such an injunction effectively extinguishes the creditor's claim because the creditor is forever prohibited

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[39] *See, e.g.*, *In re* Global Ocean Carriers Ltd., 251 B.R. 31, 42–43 (Bankr. D. Del. 2000) (mistakenly applying the standards used to assess releases of direct claims to a release of derivative claims); *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 934–35 (Bankr. W.D. Mo. 1994) (failing to distinguish different types of non-debtor releases from each other and from related forms of relief).

[40] *See, e.g.*, Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1049 (5th Cir. 1987) (plan contained a provision expressly releasing a creditor's claim against a guarantor of the debtor); *In re* Digital Impact, Inc., 223 B.R. 1, 4 (N.D. Okla. 1998) (plan provided that the debtor's principal was released from all claims relating to the debtor).

[41] *See, e.g.*, Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 600 (10th Cir. 1990) (prior to confirmation of the plan, the bankruptcy court entered a permanent injunction enjoining a creditor of the debtor from prosecuting its claim against a non-debtor), *modified*, 932 F.2d 898 (10th Cir. 1991); Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 622 (9th Cir. 1989) (prior to confirmation of the plan, the debtor sought a permanent injunction enjoining a creditor from pursuing a state court lawsuit against guarantors of the debtor's obligation to the creditor); Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 283, 305–08 (Bankr. E.D. Pa. 1999) (bankruptcy court issued a postconfirmation permanent injunction barring creditors of the debtor-partnership from seeking deficiency judgments against partners that had contributed assets to the estate pursuant to a settlement with the debtor); *Master Mortgage Invest. Fund*, 168 B.R. at 932 (plan contained an injunction barring any creditor or equity holder of the debtor from suing a non-debtor regarding any transaction between the non-debtor and the debtor).

from attempting to recover from the non-debtor.[42] Third, a reorganization plan may include both a release of third parties and a permanent injunction barring creditors from attempting to collect from the released parties on the extinguished claims.[43] Each of these types of non-debtor releases has the same basic impact.

Involuntary non-debtor releases of direct claims also vary in scope. Some are quite narrow. To illustrate, a bankruptcy court may issue a permanent injunction barring an individual creditor from pursuing a single cause of action.[44] Other non-debtor releases are broader. The release in *In re Dow Corning Corp.* prohibits all women injured by Dow Corning's silicone breast implants from suing the company's shareholders for their injuries.[45] Additionally, the release requested in *In re Digital Impact, Inc.* would have barred anyone from suing the debtor's principal for any claims related to the debtor.[46] Finally, some releases purport to extinguish *all* of a non-debtor's liabilities.[47] This type of release provides the third party with relief that is

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42 *W. Real Estate Fund*, 922 F.2d at 600 ("By permanently enjoining [the creditor's] actions against [the non-debtor], the bankruptcy court, in essence, discharged [the non-debtor's] liability."); Meltzer, *supra* note 27, at 4 n.7 (explaining that permanent injunctions and releases have the same effect and thus that the terms will be used interchangeably in the article); Inman, *supra* note 27, at 633 n.7 ("A permanent injunction preventing a creditor from suing a third party is, in effect, a discharge of the third party's liability."); *see also Digital Impact*, 223 B.R. at 12 (holding that a non-debtor release "is equivalent to issuing a final adjudication of the merits" of the released claims); *accord also* Brubaker, *supra* note 27, at 1070.

43 *See, e.g.*, *In re* Dow Corning Corp., 255 B.R. 445, 475 (E.D. Mich. 2000) (plan both released certain claims against Dow Corning's shareholders and enjoined holders of the released claims from attempting to recover against the shareholders), *rev'd in part*, 280 F.3d 648 (6th Cir. 2002); *In re* Boston Harbor Marina Co., 157 B.R. 726, 729, 731 (Bankr. D. Mass. 1993) (plan contained both a release of all claims against the debtor's co-venturers, a former part-owner of the debtor, and an insurance company that was related to the debtor, and a permanent injunction barring prosecution of the released claims).

44 *W. Real Estate Fund*, 922 F.2d at 598 (bankruptcy court permanently enjoined the debtor's attorney from executing upon a lien against the debtor's bank); *Am. Hardwoods*, 885 F.2d at 622 (debtor sought a permanent injunction prohibiting a creditor from enforcing a *state* court judgment against the debtor's shareholder-guarantors).

45 *Dow Corning Corp*., 255 B.R. at 475; *see also In re* Sybaris Clubs, Int'l, Inc., 189 B.R. 151, 153 (Bankr. N.D. Ill. 1995) (provision in the proposed plan of reorganization contained a permanent injunction barring "all persons" from prosecuting any action against the debtor's insiders, a shareholder, and several affiliated entities relating to the sale of notes and debentures issued by the debtor).

46 *In re* Digital Impact, Inc., 223 B.R. 1, 4 (Bankr. N.D. Okla. 1998); *see also* Deutsche Bank AG v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 141 (2d Cir. 2005) (release in the plan of reorganization purported to extinguish all claims against various corporate insiders related to the debtor or its subsidiaries).

47 *See, e.g.*, Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1401 (9th Cir. 1995) (provision in the debtor's plan granted a "global release" of all claims to, *inter alia*, the debtor's children and a business he owned); *In re* Arrowmill Dev. Corp., 211 B.R. 497, 500 (Bankr. D.N.J. 1997) (chapter 11 plan stated that "[p]ursuant to § 1141 of the Code, confirmation of this Plan shall also discharge all claims against Debtor's equity Interest holders or Affiliates").

similar in scope to the bankruptcy discharge granted to the debtor, and is thus, in effect, a "non-debtor discharge."[48]

Involuntary non-debtor releases of direct claims differ from each other in another critical way. Some are part of chapter 11 plans that, by their terms, provide the dissenting creditor with full payment on the extinguished claims. 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.[49] Other reorganization plans extinguish claims through non-debtor releases without providing for payment in full to the creditors.[50] In those bankruptcies, the third-party release constitutes an "actual release" because at least part of the creditor's claim is discharged without compensation.

Dow Corning's bankruptcy offers a good example of a channeling release. Under the plan of reorganization, all women who purchased the company's silicone breast implants are to be paid in full for their injuries.[51] Since their claims against Dow Corning's shareholders flow from the same harm, the women also will receive full compensation on their causes of action against the owners.[52]

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[48] Indeed, such releases are actually *broader* than a discharge because certain liabilities of a debtor are non-dischargeable under § 523(a) of the Code. 11 U.S.C. § 523(a) (2000); *see also* Brubaker, *supra* note 27, at 1000 ("In fact, non-debtor releases have been used to grant many individuals discharge from debts that could not, or at least arguably could not, be discharged through an actual bankruptcy filing by the non-debtor.").

[49] *Digital Impact*, 223 B.R. at 9; *see also In re* A.H. Robins Co., 88 B.R. 742, 754 (E.D. Va. 1988) (concluding that where A.H. Robins's plan paid all Dalkon Shield claimants in full, the non-debtor release extinguishing the claims of the injured women against third parties was within the courts equitable power to "channel claims to a specific *res*"), *aff'd*, 880 F.2d 694 (4th Cir. 1989); *see also infra* notes 228–40 and accompanying text (containing a further discussion of "channeling"). *But see In re* Am. Family Enters., 256 B.R. 377, 386–87, 390–92, 405–08 (D.N.J. 2000) (referring to a non-debtor release as a "channeling" release even though the plan did not provide for payment in full on the extinguished claims). *See generally* Brubaker, *supra* note 27, at 1036–38 (contending that non-debtor releases bear little resemblance to traditional "channeling" injunctions).

[50] *See, e.g.*, Mellon Bank v. M.K. Siegel, 96 B.R. 505, 506 (E.D. Pa. 1989) (plan stated that payment to a creditor of the debtor was "in full settlement" of all of the creditor's claims against the debtor and a guarantor even though the plan only provided the creditor with $10,000 of the $17,000 owed); *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 65–66 (Bankr. W.D. Pa. 1994) (plan stated that the debtor's shareholder would release his individual claims against the debtor's lessor; the shareholder's claims would not have been paid in full under the plan).

[51] *In re* Dow Corning Corp., 287 B.R. 396, 415–16 (E.D. Mich. 2002).

[52] *See* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 653 (6th Cir. 2002) (noting that the implant purchasers sued Dow Corning *and* its two shareholders for their injuries); *Dow Corning Corp.*, 287 B.R. at 415–16 (holding that all of the released claims are to be paid in full).

Most bankruptcies in which a plan of reorganization contains a third-party release *and* provides full payment on the extinguished claims mirror *Dow Corning*—the debtor and the released third party are co-obligors of some type.[53] That is because payment in full on a claim against a debtor eliminates the claimant's rights against any codebtor (e.g., a guarantor or a jointly and severally liable tort-feasor) through the prohibition on double recovery.[54] If the debtor and third party are *not* co-obligors, payment in full is only possible where the creditor receives additional compensation beyond any plan distributions intended to satisfy its claims against the debtor.

B. Voluntary Non-Debtor Releases of Direct Claims

A plan of reorganization may contain a clause stating that creditors can obtain additional payment from a non-debtor if they agree to release their claims against the third party.[55] This is a "voluntary" or "consensual" non-debtor release. The legality of such provisions has little bearing on whether a bankruptcy court may extinguish a third party's liability over its creditor's objection, the issue addressed in this Article. The validity of a consensual release is primarily a question of contract law[56] because such releases are "no different from any other settlement or contract."[57] Accordingly, as long as the release satisfies the requirements for a binding agreement—i.e., offer, acceptance, and consideration—the vast majority of courts believe it is perfectly valid under the Code.[58] The few decisions that have adopted a

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[53] *See, e.g.*, Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 700–01 (4th Cir. 1989) (plan provided Dalkon Shield claimants with payment in full for their injuries and enjoined them from suing any tort-feasors jointly and severally liable with the debtor for the same harm); *In re* Eller Bros., Inc., 53 B.R. 10, 11–12 (Bankr. M.D. Tenn. 1985) (plan provided payment in full to a creditor and released the guarantor of the debtor's liability).

[54] *See* 22 AM. JUR. 2D *Damages* § 28 (2003) ("The law abhors duplicative recoveries; in other words, a plaintiff who is injured by reason of a defendant's behavior is, for the most part, entitled to be made whole, not to be enriched.") (footnote omitted).

[55] *See, e.g.*, *In re* Resorts, Int'l, Inc., 145 B.R. 412, 460 (Bankr. D.N.J. 1990) (plan contained provisions enabling creditors to release all claims against several non-debtors in exchange for additional compensation); *In re* Monroe Well Serv., Inc., 80 B.R. 324, 329 (Bankr. E.D. Pa. 1987) (same).

[56] Feldstein, *supra* note 27, at 25 n.6 (explaining that the validity of consensual releases is largely a question of contract law); Starr, *supra* note 27, at 487 (observing that in the case of consensual releases, "the bankruptcy court simply approves a tripartite settlement among the debtor, the creditors, and the insider and does not use the discharge power in a manner forbidden by the Code"); Inman, *supra* note 27, at 638 ("Because the release with consent approach is more of a contract issue, it is outside the scope of this discussion . . . .").

[57] *In re* Arrowmill Dev. Corp., 211 B.R. 497, 506 (Bankr. D.N.J. 1997).

[58] *In re* Specialty Equip. Cos., 3 F.3d 1043, 1046–47 (7th Cir. 1993) (holding that consensual non-debtor releases do not violate § 524(e) and are permissible under the Code); *In re* Digital Impact, Inc., 223 B.R. 1,

contrary position[59] all rely upon a Seventh Circuit case[60] that was subsequently overturned.[61]

C. *Non-Debtor Releases of Derivative Claims and Rights Under a Debtor's Insurance Policies*

Certain types of *involuntary* non-debtor releases are also beyond the scope of this Article. The first is a release of derivative (rather than direct) claims—i.e., shareholder derivative claims. Such claims are actually property of the estate rather than property of the debtor's creditors or shareholders.[62] Thus, the release of derivative claims involves a different set of issues from a release

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14–15 (N.D. Okla. 1998) (holding that bankruptcy courts do not have the power to grant involuntary non-debtor releases, but may issue voluntary third-party releases where such provisions comply with general principles of contract law); *In re* AOV Industries, Inc., 31 B.R. 1005, 1010 (D.D.C. 1983) (concluding that consensual non-debtor releases are not barred by § 524), *rev'd in part on other grounds*, 792 F.2d 1140 (D.C. Cir. 1986); *In re* Cent. Jersey Airport Servs., Inc., 282 B.R. 176, 182–83 (Bankr. D.N.J. 2002) (holding that a voluntary release does not implicate § 524(e)); *Arrowmill Dev. Corp.*, 211 B.R. at 506–07 (holding that involuntary non-debtor releases are not permissible, but stating in dicta that voluntary releases are valid); *In re* Boston Harbor Marina Co., 157 B.R. 726, 730–31 (Bankr. D. Mass. 1993) (stating in dicta that voluntary non-debtor releases are valid); *Resorts, Int'l*, 145 B.R. at 460 (permitting voluntary non-debtor releases to be included in the debtor's plan because such releases are "purely contractual between the parties to the release" and thus do not run afoul of § 524(e)); *In re* Apex Oil Co., 118 B.R. 683, 701 (Bankr. E.D. Mo. 1990) (concluding that consensual non-debtor releases do not violate § 524(e)); *Monroe Well Serv.*, 80 B.R. at 334–35 (stating in dicta that involuntary non-debtor releases violate § 524(e), but holding that "a plan provision permitting individual creditors the option of providing a voluntary release to nondebtor plan funders does not violate 11 U.S.C. § 524(e)"); *see also* Feldstein, *supra* note 27, 25 n.6 ("A voluntary, creditor-by-creditor election to release nondebtors in exchange for additional consideration is permissible under the bankruptcy code and valid under state law."). The courts are split on how consent to a non-debtor release must be shown. According to some, voting in favor of a plan is insufficient to manifest assent; the creditor must expressly sign off on the release. *See, e.g.*, *Arrowmill Dev. Corp.*, 211 B.R. at 507. Other courts think a mere vote in favor of a reorganization plan is sufficient. *See, e.g.*, *Specialty Equip. Cos.*, 3 F.3d at 1045–47 (holding that a vote for confirmation of the plan is sufficient to indicate acceptance of a voluntary non-debtor release); *In re* After Six, Inc., No. 93-11150DAS, 1994 WL 45471, at *1 (Bankr. E.D. Pa. Feb. 9, 1994) (approving of provisions releasing a large number of non-debtors from all claims held by those voting for the plan); *In re* W. Coast Video Enters., Inc., 174 B.R. 906, 911 (Bankr. E.D. Pa. 1994) (same). For a thorough discussion of consensual non-debtor releases, see generally Meltzer, *supra* note 27, at 33–39.

[59] *See, e.g.*, Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985) (holding that bankruptcy courts do not have the authority to release claims against non-debtors even if the creditors consent to such action); *In re* Future Energy Corp., 83 B.R. 470, 486 (Bankr. S.D. Ohio 1988) (same).

[60] Union Carbide v. Newboles, 686 F.2d 593, 595 (7th Cir. 1982) (holding that under the Bankruptcy Act creditor approval cannot effectuate a non-debtor release), *overruled by Specialty Equip. Cos.*, 3 F.3d at 1046–47. *See, e.g.*, *Future Energy Corp.*, 83 B.R. at 486 (citing *Union Carbide* in holding that consensual third-party releases are invalid).

[61] *Specialty Equip. Cos.*, 3 F.3d at 1046–47 (overturning *Union Carbide*).

[62] Sobchack v. Am. Nat'l Bank & Trust Co. of Chicago (*In re* Ionosphere Clubs, Inc.), 17 F.3d 600, 604 (2d Cir. 1994); *In re* Texaco, Inc., 84 B.R. 893, 900 (Bankr. S.D.N.Y. 1988), *appeal dismissed by* 92 B.R. 38 (S.D.N.Y. 1988).

of a creditor's direct rights against a non-debtor.[63] Indeed, the resolution of derivative claims is expressly provided for in the Code,[64] and bankruptcy courts may issue permanent injunctions to protect any such resolution.[65]

The second type of distinguishable involuntary non-debtor release is one that eliminates a party's rights under an insurance policy owned by the debtor, such as the interests of a co-insured or a tort claimant injured by the debtor's conduct.[66] An insurance company often will not settle with a debtor unless the compromise terminates all of its duties under the policy at issue. In such circumstances, compromise is impossible without a release of all co-insureds' or tort claimants' rights against the insurer. Some courts have approved of non-debtor releases that extinguish these rights and channel the claims to the proceeds of the debtor's settlement with the insurance company.[67] A debtor's

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63 *See In re* Pacific Gas and Electric Co., 304 B.R. 395, 418 n.26 (Bankr. N.D. Cal. 2004) (distinguishing authorities holding that § 524(e) proscribes the involuntary release of a creditor's claims against a non-debtor because the release in the debtor's plan of reorganization only extinguished claims belonging to the estate); Unarco Bloomington Factory Workers v. UNR Indus., Inc., 124 B.R. 268, 277–79 (N.D. Ill. 1990) (holding that § 524(e) did not apply to a permanent injunction in the plan because the provision only barred lawsuits asserting derivative claims; explaining that the court did not need to consider whether a non-debtor release of direct claims is permissible because such a release is "even broader than the one at issue here"); Huddleston v. Nelson Bunker Hunt Trust Estate, 117 B.R. 231, 234 (N.D. Tex. 1990) (concluding that the court did not need to address whether a release in the plan violated § 524(e) because the provision only extinguished derivative claims), *aff'd*, 935 F.2d 1290 (5th Cir. 1991); *Texaco*, 84 B.R. at 900–01 (stating in dicta that § 524(e) bars the extinguishing of direct claims against non-debtors, but holding that it does not prohibit the release of derivative claims because such claims belong to the estate).

64 *See, e.g.*, 11 U.S.C. § 1123(b)(3)(A) (2000) ("[A] plan may . . . provide for . . . the settlement or adjustment of any claim or interest belonging to the debtor or to the estate . . . ."); *see also In re* General Homes Corp., 134 B.R. 853, 861 (Bankr. S.D. Tex. 1991) (implying that § 524(e) does not bar releases of derivative claims because § 1123(b)(3)(A) expressly allows for the extinguishing of such claims).

65 *Ionosphere Clubs*, 17 F.3d at 602–04 (affirming an order of the bankruptcy court enjoining the debtor's preferred stockholders from suing certain managers of the debtor for breach of fiduciary duty and tortious interference because the claims were derivative, belonged to the estate, and thus were extinguished as part of a settlement between the debtor and the managers); *In re* Energy Cooperative, Inc., 886 F.2d 921, 929 (7th Cir. 1989) ("The power of the court under [section 105(a)] . . . includes the power to issue an injunction enjoining third parties from pursuing actions which are the exclusive property of the debtor estate and are dismissed pursuant to a settlement agreement.").

66 *See generally In re* Dow Corning Corp., 198 B.R. 214, 233–42 (Bankr. E.D. Mich. 1996) (discussing the nature of an injured party's interest in the insurance policies of the tortfeasor).

67 *See, e.g.*, MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 90–91 (2d Cir. 1988) (permanently enjoining a co-insured from suing the debtor's insurance companies for any claims relating to policies that were subject to a settlement between the debtor and its insurers); *Dow Corning Corp.*, 198 B.R. at 244–47 (permanently enjoining all parties tortiously injured by the debtor's products from bringing claims against the debtor's insurers relating to policies that were subject to a settlement between the debtor and its insurers). *But see* In re Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (holding that the court did not have sufficient power under § 105(a) to grant a non-debtor release, as part of a settlement between the debtor and its insurance company, that extinguished the contractual rights of a co-

insurance policies are generally property of the estate.[68] Accordingly, a tort claimant's or a co-insured's claim under these policies is often, in essence, a claim against the estate itself. Releasing such rights is altogether different from releasing a creditor's claim against an independent third party, such as a guarantor.[69]

Despite these distinctions, derivative and insurance releases do involve several of the same issues as releases of direct claims against non-debtors.[70] Accordingly, some derivative and insurance cases are discussed below.[71]

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insured under the policy because, *inter alia*, the co-insured's rights were not part of the debtor's estate), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992).

[68] *Johns-Manville Corp.*, 837 F.2d at 92; Am. Bankers Ins. Co. of Fla. v. Maness, 101 F.3d 358, 362 (4th Cir. 1996); Estate of Lellock v. Prudential Ins. Co., 811 F.2d 186, 189 (3d Cir. 1987); Aetna Cas. & Sur. Co. v. Jasmine, Ltd. (*In re* Jasmine, Ltd.), 258 B.R. 119, 128–29 (D.N.J. 2000); *see also* 11 U.S.C. § 541(a)(1) (2000) (providing that a debtor's estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case," with minor exceptions). *But see* Landry v. Exxon Pipeline Co., 260 B.R. 769, 785–86 (Bankr. M.D. La. 2001) (discussing a split in the courts regarding whether the *proceeds* of certain types of insurance policies constitute estate property).

[69] *See In re* Elsinore Shore Assoc., 91 B.R. 238, 253 (Bankr. D.N.J. 1988) (distinguishing *Johns-Manville*, the leading insurance release case, because the claims at issue there were against property of the estate, whereas *Elsinore Shore Associates* requested the enjoining of claims against independent third parties); Brubaker, *supra* note 27, at 962 n.3 ("This article will not discuss . . . insurance injunctions. Insurance injunctions involve property of the estate issues that are not implicated by broader non-debtor releases."). *See generally* Charles A. Beckham, Jr., *It's All an Unsecured Claim to Me: The Tortious Interference of Bankruptcy Law with Liability Insurance Proceeds*, 22 TEX. TECH. L. REV. 779 (1991); Barry L. Zaretsky, *Insurance Proceeds in Bankruptcy*, 55 BROOK. L. REV. 373 (1989).

[70] Some courts and commentators have suggested that a third type of release is distinct from the non-debtor releases at issue here—those shielding partners in a general partnership from the partnership's creditors. *See, e.g.*, *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 67 (Bankr. W.D. Pa. 1994) (distinguishing releases of general partners in a debtor-partnership from a plan provision releasing a claim by the debtor's shareholder against a creditor of the debtor); Brubaker, *supra* note 27, at 962 n.3 ("Likewise, partners' liability to a debtor-partnership for partnership deficiencies make non-debtor partner releases and injunctions, which protect individual partners from partnership creditors, unique and beyond the scope of this article."); Buschman, *supra* note 27, at 932 (concluding that injunctions in favor of individual partners of a general partnership are distinguishable from injunctions on behalf of guarantors); Lewis, *supra* note 27, at 174–76 (arguing that non-debtor releases in partnership cases are unique because the general partners are responsible for all of the partnership's debts and thus "such assets in essence constitute property of the debtor's partnership estate"). However, most courts apply (correctly, in my view) the same standards to partner releases and other non-debtor releases. *See, e.g.*, Seaport Automotive Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts, Inc.), 113 B.R. 610, 612, 614–16 (B.A.P. 9th Cir. 1990); Greer v. Gaston & Snow (*In re* Gaston & Snow), No.: 93-CV-8517(JGK), 93-CV-8628(JGK), 1996 WL 694421, at *2, *5-*6 (S.D.N.Y. Dec. 4, 1996); Myerson & Kuhn v. Brunswick Assoc. Ltd. P'ship (*In re* Myerson & Kuhn), 121 B.R. 145, 149–51, 156–57 (S.D.N.Y. 1990); Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 305–08 (Bankr. E.D. Pa. 1999); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 685–87 (Bankr. D.D.C. 1992). Thus, this Article does not distinguish between nonpartner and partner releases.

[71] *See, e.g.*, *supra* notes 216–40 and accompanying text. As Professor Brubaker wisely cautioned, however, one must be careful not to confuse the various types of releases and "indiscriminately" rely upon decisions in one context as authority in another. *See* Brubaker, *supra* note 27, at 962 n.3; *see also* In re Forty-

D. Provisional Injunctions Shielding Non-Debtors

There is one final type of chapter 11 relief that must be distinguished from an involuntary non-debtor release of direct claims. Some reorganization plans contain postconfirmation injunctions or releases that only *temporarily* or *conditionally* prohibit a creditor from pursuing claims against third parties. For example, the plan in *In re Rohnert Park Auto Parts, Inc.* restrained creditors from taking legal action against any co-obligors of the debtor for five years.[72] In *In re Mac Panel Co.*, the plan included an injunction and a release barring a creditor from prosecuting the debtor's shareholders as long as the debtor complied with the plan of reorganization, under which the creditor was to be paid in full.[73] Any deviation from the plan terminated the injunction and voided the release to the extent a deficiency remained.[74] Unlike non-debtor releases, such provisions do not actually extinguish the liability of a third party. Thus, in the event that the debtor does not pay the creditor's claim in full—whether by design or because the debtor was unable to comply with a plan that, by its term, provided full compensation—the creditor may seek its shortage from the third party. One court has aptly characterized temporary or conditional injunctions and releases of this type as "provisional injunctions."[75]

To be sure, a provisional injunction, when combined with the debtor's payments to the creditor under the plan of reorganization, may effectively release the creditor's claims against a third party. If the debtor pays the creditor in full before the injunction is terminated, any claim the creditor had against a codebtor is discharged by the prohibition on double recovery.[76] But

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Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (distinguishing a release of the derivative rights of a party claiming insurance proceeds through the debtor from a release of the direct rights of a party actually insured under the policy, and holding that § 105(a) may only be used to grant the former type of relief), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992).

[72] 113 B.R. 610, 612, 615 (B.A.P. 9th Cir. 1990).

[73] No. 98-10952C-11G, 2000 WL 33673757, at *8 (Bankr. M.D.N.C. Feb. 24, 2000).

[74] *Id.*; *see also In re* Seatco, Inc. 257 B.R. 469, 474 (Bankr. N.D. Tex. 2001) (plan temporarily enjoined any creditor with an allowed claim from proceeding against the debtor's officers and directors, *inter alia*, for collection of the allowed claim as long as the debtor complied with the terms of the reorganization plan; apparently, the injunction was to expire upon consummation of the plan, permitting collection efforts against the directors and officers to recover deficiencies).

[75] *See In re* Dow Corning Corp., 244 B.R. 721, 743 (Bankr. E.D. Mich. 1999) (using the term "provisional injunction" in reference to a hypothetical postconfirmation temporary injunction that would restrain a creditor from pursuing a non-debtor only until the assets available under the plan are exhausted), *rev'd*, 255 B.R. 445, 480 (E.D. Mich. 2000), *rev'd in part*, 280 F.3d 648, 658 (6th Cir. 2002).

[76] *See* 22 AM. JUR. 2D *Damages* § 28 (2003) ("The law abhors duplicative recoveries; in other words, a plaintiff who is injured by reason of a defendant's behavior is, for the most part, entitled to be made whole, not to be enriched.") (footnote omitted); *see also In re* Shaw Aero Devices, Inc., 283 B.R. 349, 353 (Bankr. M.D.

whereas a non-debtor release extinguishes the creditor's claim *immediately*, a provisional injunction, like those in *Rohnert* and *Mac Panel*, does not eliminate the third party's liability until the creditor has *in fact* received full payment.

The fundamental difference, then, between a provisional injunction and a non-debtor release is that the former places the risk of plan failure—the risk that the debtor will default on its plan obligations—on the non-debtor, while the latter places the risk on the creditor.[77] A provisional injunction is thus a less extreme remedy than a non-debtor release, and if a court believes that such an injunction is invalid, it likely holds the same view with respect to non-debtor releases.[78]

As I noted above, the focus of this Article is involuntary non-debtor releases of direct claims, which I shall henceforth refer to simply as "non-debtor releases" or "third-party releases."

II. THE EQUITABLE AUTHORITY AND DISCHARGE PROVISIONS OF THE BANKRUPTCY CODE

The validity of non-debtor releases turns on the scope and interplay of the Code provisions that (1) invest bankruptcy courts with equitable powers, and

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Fla. 2002) (upholding a provisional injunction and observing that once the debtor has paid the creditors in full, the creditors' rights against a guarantor of the debtor's obligations will be extinguished).

77 *See Dow Corning Corp.*, 244 B.R. at 743 (explaining that, unlike a provisional injunction, a non-debtor release places undue risk upon the creditor barred from suing); *cf. In re* Mac Panel, No. 98-10952C-11G, 2000 WL 33673757, at *11 (Bankr. M.D.N.C. Feb. 24, 2000) ("Because VPC will receive full payment of its claim over time, however, the court finds that it is appropriate to condition the injunction on Mac Panel meeting its obligations to VPC under the Modified Plan."). A provisional injunction still places some risk on the creditor. There is no guarantee that the non-debtor will be available to satisfy any deficiency not paid by the debtor when the provisional injunction expires. In the absence of an injunction, the creditor could collect immediately from the non-debtor, eliminating any such risk. *See In re* Prussia Assoc., 322 B.R. 572, 598–99 (Bankr. E.D. Penn. 2005) (observing that because the primary guarantor shielded by the provisional injunction in the debtor's plan was seventy-four years old, there was a reasonable chance that the guarantor would die before the injunction expired, preventing the creditor from recovering in the event that the debtor defaulted on its plan obligations).

78 Admittedly, it is not always easy to distinguish a non-debtor release from a provisional injunction. *See, e.g.*, *In re* Sybaris Clubs Int'l, Inc., 189 B.R. 152, 153 (Bankr. N.D. Ill. 1995) (plan provided for payment in full, permanently enjoined prosecution of certain claims against the debtor's shareholder and stated that the injunction would be lifted in the event of a material default, but did not specify whether failure to pay a released claim in full constituted such a default; if lack of full payment was not a material default, then the provision was a non-debtor release rather than a provisional injunction). And courts sometimes apply the same legal standard to each. *See, e.g.*, *Mac Panel*, 2000 WL 33673757, at *9 (applying to a provisional injunction the test that pro-release courts generally use in assessing the validity of a release).

(2) define the scope of the debtor's discharge. Part II contains an overview of these statutes.

A. *Sections 105(a) and 1123(b)(6) and the General Equitable Powers of Bankruptcy Courts*

Bankruptcy courts have long been regarded as courts of equity.[79] Section 105(a) is the primary source of their general equitable power.[80] It states that "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[81] The statute is "similar in effect to the All Writs Statute,"[82] which provides that the "Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law."[83] But § 105(a) also codified "any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs Statute"[84] and expanded these powers beyond those granted in prior bankruptcy laws.[85]

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[79] *See* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984) ("The Bankruptcy Court is a court of equity . . . ."); *accord* Katchen v. Landy, 382 U.S. 323, 327 (1966); U.S. Nat'l Bank v. Chase Nat'l Bank, 331 U.S. 28, 36 (1947); Pepper v. Litton, 308 U.S. 295, 304–05 (1939).

[80] *See supra* note 8.

[81] 11 U.S.C. § 105(a) (2000).

[82] H.R. REP. No. 95-595, at 316 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6273; *accord In re* G.S.F. Corp., 938 F.2d 1467, 1475 n.6 (1st Cir. 1991) (quoting the House Report).

[83] 28 U.S.C. § 1651 (2000).

[84] H.R. REP. No. 95-595, at 317 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6274.

[85] "Section 105(a) is derived from section 2a(15)" of the Bankruptcy Act. H.R. REP. No. 95-595 at 316, *reprinted in* 1978 U.S.C.C.A.N. at 6273. Section 2a(15) provided that bankruptcy courts may "[m]ake such orders, issue such process, and enter such judgments, in addition to those specifically provided, as may be necessary for the enforcement of the provisions of this Act; provided, however, that an injunction to restrain a court may be issued by the judge only." 11 U.S.C. § 11a(15) (repealed 1979).

> Section 105(a) is considered broader than former § 2a(15) because § 105(a) uses the phrase "necessary *or appropriate* to carry out the provisions of this title" instead of "necessary for the enforcement of the provisions of" the Act. The addition of "or appropriate" implemented a congressional purpose that bankruptcy courts be able to deal comprehensively with bankruptcy cases.

Meltzer, *supra* note 27, at 13 n.41 (emphasis added); *accord* 2 COLLIER ON BANKRUPTCY ¶ 105.LH[2], at 105–106 (Lawrence P. King ed., 15th ed. rev. 1998) ("Section 105 is much broader than former Section 2a(15), and constituted a major departure from that law . . . ."); Boyle, *supra* note 27, at 426 ("[S]ection 105(a) contemplates greater equitable powers than those embodied in its predecessor, section 2(a)(15)."); *see also* Bird v. Carl's Grocery Co. (*In re* NWFX, Inc.), 864 F.2d 593, 595 (8th Cir. 1989) ("[Section 105(a)] is even broader than Section 2a(15) of the Bankruptcy Act from which it is derived."); Johnson v. First Nat'l. Bank of Montevideo, 719 F.2d 270, 273 (8th Cir. 1983) (observing that § 105(a) "is in certain respects broader in scope than its predecessor"); Resolution Trust Corp. v. Allied Stores Corp. (*In re* Federated Dept. Stores, Inc.), 133

Section 105(a) enables bankruptcy courts to issue numerous types of orders.[86] Perhaps the most significant are injunctions. For example, the statute permits a bankruptcy court to prohibit third parties from distributing assets that may belong to the estate.[87] Section 105(a) also empowers bankruptcy courts to temporarily enjoin lawsuits that are exempt from the automatic stay,[88] including legal actions between non-debtors.[89] Stays of litigation involving third parties "have been justified when [both (1)] the non-debtor's undivided attention is required" for the development of a chapter 11 plan and (2) the court concludes that a lawsuit would distract the third party, hampering the reorganization effort.[90] Courts have also granted "non-debtor stays" when necessary to protect the estate from judgments that would collaterally estop the

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B.R. 886, 890 (Bankr. S.D. Ohio 1991) ("The legislative history of Section 105 indicates that the limitations on equitable powers of the Bankruptcy Court were expanded . . . . Congress recognized that the increased powers and jurisdictions of the new Bankruptcy Court required that the Bankruptcy Judge be permitted equitable powers in fulfilling his substantive duties to protect the estate, creditors, and debtors in a bankruptcy action.").

86 *See generally* 2 COLLIER ON BANKRUPTCY ¶¶ 105.03-.04 (Lawrence P. King ed., 15th ed. rev. 1996, 1999, 2000, 2004, & 2005) (containing an extended discussion of the powers of bankruptcy courts under § 105(a)); Daniel B. Bogart, *Resisting The Expansion of Bankruptcy Court Power Under Section 105 Of The Bankruptcy Code: The All Writs Act And An Admonition From Chief Justice Marshall*, 35 ARIZ. ST. L.J. 793, 794 (2003) ("[B]ankruptcy courts have used this Code section to allow for an enormous array of orders.") (referring to § 105(a)).

87 2 COLLIER ON BANKRUPTCY ¶ 105.03[5][a] (Lawrence P. King ed., 15th ed. rev. 2004).

88 Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 599 (10th Cir. 1990), *modified*, 932 F.2d 898 (10th Cir. 1991); 2 COLLIER ON BANKRUPTCY ¶ 105.03, at 105–23 (Lawrence P. King ed., 15th ed. rev. 1996 & 2000) ("The most notorious use of section 105 has been to seek to enjoin actions which, for one reason or another, are not stayed by the automatic stay of section 362."); H.R. REP. No. 95-595, at 342 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6298 (indicating that § 105 grants bankruptcy courts the power to stay actions not covered by the automatic stay); S. REP. No. 95-989, at 51, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5837 (same). Under § 362(a), the filing of a bankruptcy petition operates as an automatic stay which bars nearly all debt collection efforts against the debtor or the property of its estate. 11 U.S.C. § 362(a), (b) (2000).

89 *W. Real Estate Fund*, 922 F.2d at 601 ("[A] temporary stay prohibiting a creditor's suit against a non-debtor . . . during the bankruptcy proceeding may be permissible to facilitate the reorganization process in accord with the broad approach to nondebtor stays under section 105(a) . . . ."); Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 624 (9th Cir. 1989) ("Section 105(a) empowers the court to enjoin preliminarily a creditor from continuing an action or enforcing a state court judgment against a nondebtor prior to confirmation of a plan.") (citing A.H. Robins Co. v. Piccinin (*In re* A.H. Robins Co.), 788 F.2d 994, 1002–03 (4th Cir. 1986)); Brubaker, *supra* note 27, at 970 ("The propriety of . . . temporary non-debtor stays in certain circumstances has gained widespread acceptance in the courts . . . .").

90 *In re* Digital Impact, Inc., 223 B.R. 1, 13 n.6 (N.D. Okla. 1998); *accord* Brubaker, *supra* note 27, at 970; *see also* Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 979 (1st Cir. 1995) ("[A] temporary injunction is sometimes needed to protect non-debtors (e.g., a corporate debtor's principals and managing officers) whose time and energy should not be diverted to collateral lawsuits and away from the effort to reorganize the debtor."); 2 COLLIER ON BANKRUPTCY ¶¶ 105.03[1][a], 105.03[1][b][i] (Lawrence P. King ed., 15th ed. rev. 1996, 1999, & 2000).

debtor.[91] However, non-debtor stays are atypical; most third-party litigation does not sufficiently impact the administration of the bankruptcy case to warrant such relief.[92] As a general matter, courts temporarily enjoin proceedings against third parties only when it is shown that the stay is essential to the debtor's reorganization.[93]

Non-debtor stays must not be confused with non-debtor *releases*[94] or provisional injunctions. Stays delay actions against a third party until the lawsuit will no longer impair the debtor's effort to reorganize.[95] Such orders do not extend past confirmation of the debtor's plan and thus do not expressly or implicitly extinguish claims.[96] Third-party releases, however, permanently bar attempts to collect from the non-debtor.[97] And provisional injunctions, while not eliminating liability, also continue after confirmation.[98]

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91 Am. Film Tech., Inc. v. Taritero (*In re* Am. Film Tech., Inc.), 175 B.R. 847, 850–54 (Bankr. D. Del. 1994) (holding that stays of litigation against managers in their official capacity are valid because the judgment in such a lawsuit would have collateral estoppel effect on the corporate debtor); *see also* Inman, *supra* note 27, at 632 n.5 ("There is a general consensus that § 105(a) empowers courts to issue temporary or preliminary injunctions barring suits against nondebtor third parties in order to preserve the debtor estate.").

92 *See* 2 COLLIER ON BANKRUPTCY ¶ 105.03[1], at 105–24.1 (Lawrence P. King ed., 15th ed. rev. 2000) (noting that actions against third parties "normally would not concern the estate").

93 *See, e.g.*, Rustic Mfg. Inc. v. Marine Bank Dane County (*In re* Rustic Mfg., Inc.), 55 B.R. 25, 31–32 (Bankr. W.D. Wis. 1985) (preliminarily enjoining a creditor from prosecuting a state court action against several guarantors of its loan to the debtor until the confirmation of a plan of reorganization, where the court found that the lawsuit would lead to "a major disruption in the debtor's progress towards reorganization" because it would seriously distract the guarantors, who were also the sole shareholders of the debtor, from operating the business and might lead to the creditor obtaining the guarantors' shares); *see generally* 2 COLLIER ON BANKRUPTCY ¶¶ 105.03[1]-[2] (Lawrence P. King ed., 15th ed. rev. 1996, 1999, 2000, & 2004) (offering an extensive analysis of non-debtor stays).

94 *See* Gillman v. Cont'l. Airlines (*In re* Cont'l. Airlines), 203 F.3d 203, 217 n.17 (3d Cir. 2000) ("the entry of a temporary injunction or extension of the automatic stay during the pendency of a bankruptcy case . . . is quite a different matter" from a non-debtor release); *In re* Sybaris Club Int'l, Inc., 189 B.R. 152, 157 & n.7 (N.D. Ill. 1995) (distinguishing non-debtor releases from non-debtor stays because the former extend "beyond confirmation of the bankruptcy case"); Starr, *supra* note 27, at 487 ("A discharge differs from a temporary stay of litigation in that a stay does not strip a creditor of its claim but merely suspends the creditor's ability to pursue them.").

95 Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 979 (1st Cir. 1995); *In re* Digital Impact, Inc., 223 B.R. 1, 13 n.6 (Bankr. N.D. Okla. 1998).

96 *Digital Impact*, 223 B.R. at 13 n.6; Brubaker, *supra* note 27, at 970 ("[S]upplementary non-debtor stays do not extend beyond plan confirmation."); *see also Monarch Life Ins.*, 65 F.3d at 979 (noting that non-debtor stays "normally lapse—at the latest—following confirmation of the chapter 11 plan").

97 *See supra* notes 40–43 and accompanying text; *see also* Starr, *supra* note 27, at 487 ("A discharge differs from a temporary stay of litigation in that a stay does not strip a creditor of its claims but merely suspends the creditor's ability to pursue them.")

98 *See supra* notes 72–75 and accompanying text.

Most § 105(a) injunctions issued in chapter 11 cases expire prior to or upon confirmation of the debtor's plan of reorganization.[99] However, it is well-established that during a bankruptcy proceeding, courts may grant injunctions that extend beyond confirmation. For example, as previously noted, § 105(a) may be used to permanently bar third parties from attempting to assert claims that are property of the estate and have been extinguished pursuant to a settlement.[100] In addition, when a debtor sells an asset "free and clear" pursuant to § 363(f) of the Code,[101] the bankruptcy court may permanently enjoin a creditor from attempting to enforce any interest it previously possessed in the property, such as a lien.[102]

Bankruptcy courts may also employ § 105(a) to issue injunctions subsequent to confirmation. Indeed, even the Ninth Circuit, the leading judicial opponent of third-party releases, has noted that "[s]ection 105(a) permits the court to issue both preliminary and permanent injunctions *after confirmation of a plan* to protect the debtor and the administration of the bankruptcy estate."[103] But the types of postconfirmation injunctions that have anything approaching universal assent are granted in narrow circumstances,

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99 *See generally* 2 COLLIER ON BANKRUPTCY ¶ 105.03 (Lawrence P. King ed., 15th ed. rev. 1996 & 2000) (identifying various types of § 105(a) injunctions, most of which are issued during the pendency of the debtor's bankruptcy and terminate prior to or upon confirmation of the debtor's plan).

100 *In re* Energy Coop., Inc., 886 F.2d 921, 929 (7th Cir. 1989) ("The power of the court under [§ 105(a)] . . . includes the power to issue an injunction enjoining third parties from pursuing actions which are the exclusive property of the debtor estate and are dismissed pursuant to a settlement agreement."); *see also* Sobchack v. Am. Nat'l Bank & Trust Co. of Chicago (*In re* Ionosphere Clubs, Inc.), 17 F.3d 600, 602–04 (2d Cir. 1994) (affirming an order of the bankruptcy court enjoining the debtor's preferred stockholders from suing certain managers of the debtor for breach of fiduciary duty and tortious interference because the claims were derivative, belonged to the estate, and thus were extinguished as part of a settlement between the debtor and the managers) (no citation to § 105(a)); *supra* notes 62–65 and accompanying text (taxonomy discussion of derivative releases).

101 11 U.S.C. § 363(f) (2000).

102 *See In re* Dow Corning Corp., 198 B.R. 214, 245 (Bankr. E.D. Mich. 1996) (holding that bankruptcy courts may use § 105(a) to issue an injunction barring a creditor from seeking to enforce an interest in property purchased from the debtor under § 363(f) where the injunction is "necessary and appropriate to give the 'free and clear' aspect of § 363(f) meaning"); P.K.R. Convalescent Ctrs., Inc. v. Virginia (*In re* P.K.R. Convalescent Ctrs., Inc.), 189 B.R. 90, 96 (Bankr. E.D. Va. 1995) ("Accordingly, § 105[(a)] authorizes this court to enjoin any act to collect an interest in the bankruptcy estate in contravention of a court order to sell the property free and clear of *all interests* under § 363(f)(5)."); *see also* Fogel v. Zell, 221 F.3d 955, 965 (7th Cir. 2000) ("And thus when an asset of the estate is sold by the trustee in bankruptcy free and clear of any liens, the court can enjoin a creditor from suing to enforce a preexisting lien in the asset.") (no citation to § 105(a)). For a more thorough discussion of § 363(f), see *infra* notes 228–30 and accompanying text.

103 Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 625 (9th Cir. 1989) (emphasis added); *accord* United Model Distribs., Inc. v. Ry. Express Agency, Inc. (*In re* United Model Distribs., Inc.), No. 90 B 24281, No. 91 A 1120, 1992 WL 503595, at *2 (Bankr. N.D. Ill. May 1, 1992) (same).

and then only after a substantial showing of necessity.[104] For example, courts have used § 105(a) to enjoin creditors from attempting to collect on a discharged debt[105] and to protect the qualified immunity granted to members of the official creditors' committee in the debtor's bankruptcy.[106]

In addition to injunctions, bankruptcy courts may use § 105(a) to, inter alia, disallow state court judgments obtained via fraud,[107] recharacterize claims as interests,[108] grant substantive consolidation,[109] appoint legal representatives for classes of claims,[110] allocate payments made to the IRS to specific tax liabilities of the debtor,[111] and marshal estate assets.[112] Marshaling assets "refers to the equitable power of a court to require a creditor with two discrete sources of payment to exhaust the one specified by the court before seeking

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104 *See* Spiers Graff Spiers v. Menarko (*In re* Spiers Graff Spiers), 190 B.R. 1001, 1012 (Bankr. N.D. Ill. 1996) (holding that bankruptcy courts may enter postconfirmation injunctions under § 105(a) "only where necessary to protect plan implementation from powerful activity by third parties that directly impedes the plan").

105 *See, e.g.*, Polysat, Inc. v. Union Tank Car Co. (*In re* Polysat, Inc.), 152 B.R. 886, 896 (Bankr. E.D. Pa. 1993) (enjoining a creditor from prosecuting a state court action regarding a discharged debt); Askew v. Channel (*In re* Askew), 61 B.R. 87, 89 (Bankr S.D. Ohio 1986) (same).

106 *See, e.g.*, Polygram Distrib., Inc. v. B-A Systems, Inc. (*In re* Burstein-Applebee Co.), 63 B.R. 1011, 1018–20 (Bankr. W.D. Mo. 1986) (permanently enjoining the debtor's principal's state court tortious interference and defamation action against the creditors' committee for actions taken by the committee during the course of the bankruptcy because such lawsuits would have a chilling effect on the administration of bankruptcy estates). Section 1102 of the Bankruptcy Code mandates the creation of an official committee to represent the interests of unsecured creditors. 11 U.S.C. § 1102(a)(1) (2000). Section 1103, which sets forth the duties of official committees and their members, *see* § 1103(a), (c), "has been interpreted to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members." *In re* PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000) (collecting authorities). This "immunity covers committee members for actions within the scope of their duties." *Id*; *accord* 7 COLLIER ON BANKRUPTCY ¶ 1103.05[4][a] (Lawrence P. King ed., 15th ed. rev. 2002) ("A member of an official committee has a qualified immunity from legal action for matters relating to the performance of the committee's duties."). But it does not extend to "willful misconduct or *ultra vires* acts." *PWS Holding Corp.*, 228 F.3d at 246; *accord* Philip v. L.F. Rothschild Holdings, Inc. (*In re* L.F. Rothschild Holdings, Inc.), 163 B.R. 45, 49 (S.D.N.Y. 1994).

107 Browning v. Navarro, 887 F.2d 553, 559 (5th Cir. 1989).

108 2 COLLIER ON BANKRUPTCY ¶ 105.04[4][e] (Lawrence P. King ed., 15th ed. rev. 2004) (collecting authorities).

109 *Id.* ¶ 105.04[2], at 105–63 (noting that "recently courts have focused on section 105's language to justify" substantive consolidations). Substantive consolidation "is the merging of the assets and claims of two or more estates." *Id.* For a fuller discussion of substantive consolidation, see generally 2 COLLIER ON BANKRUPTCY ¶ 105.09 (Lawrence P. King ed., 15th ed. rev. 1998 & 2005).

110 2 COLLIER ON BANKRUPTCY ¶ 105.04[4][a] (Lawrence P. King ed., 15th ed. rev. 2004).

111 United States v. Energy Res. Co., 495 U.S. 545, 548–49 (1990); *see infra* Part IV.

112 Me. Assoc. v. United States (*In re* Morahan), 53 B.R. 489, 492 (D. Me. 1985); *In re* Corso Stein Enters., Inc., 79 B.R. 584, 586–87 (Bankr. D.N.J. 1987); 2 COLLIER ON BANKRUPTCY ¶ 105.04[3] (Lawrence P. King ed., 15th ed. rev. 2004); *see also* C.T. Dev. Corp. v. Barnes (*In re* Oxford Dev. Ltd.), 67 F.3d 683, 686–87 (6th Cir. 1995) (holding that bankruptcy courts have the authority to apply the equitable doctrine of marshaling of assets under federal bankruptcy law, but failing to cite § 105(a)).

repayment from the other."[113] It is employed to prevent the creditor from destroying the rights of a junior claimant where the latter has access to only one of the two funds.[114]

Section 105(a) is not the only source of equitable authority in the Code. Bankruptcy courts also derive equitable power from § 1123(b)(6),[115] which states that a chapter 11 plan may "include any other appropriate provisions not inconsistent with the applicable provisions of this title."[116] Section 1123(b)(6) is more limited in scope than § 105(a) because the former may only be used to include items in a plan reorganization.[117] A bankruptcy court may employ § 105(a), however, at any time after the filing of a bankruptcy petition, including postconfirmation.[118] Section 1123(b)(6) is nonetheless an important source of authority, and courts have used it to include numerous types of provisions in chapter 11 plans, such as reporting requirements, debt retirement schedules, and tax payment allocations.[119]

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113 2 COLLIER ¶ 105.04[3].

114 *See* Meyer v. United States, 375 U.S. 233, 236 (1963) ("The equitable doctrine of marshalling [of assets] rests upon the principle that a creditor having two funds to satisfy his debt, may not by his application of them to his demand, defeat another creditor, who may resort to only one of the funds.") (internal quotation marks omitted); C.T. Dev. Corp. v. Barnes (*In re* Oxford Dev. Ltd.), 67 F.3d 683, 687 (6th Cir. 1995) ("If a senior lienor has a lien that extends to and covers two funds or potential funds, and if a junior lienor has recourse to only one of those funds to satisfy the debt due him, the senior lienor may be required to exhaust the fund available to him exclusively before proceeding against the fund that is also available to the junior lienor.").

115 *See* United States v. Energy Res. Co., 495 U.S. 545, 549 (1990) (holding that § 1123(b)(6) is "consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships").

116 11 U.S.C. § 1123(b)(6) (2000).

117 *Id.*

118 *See Energy Res.*, 495 U.S. at 548–50 (affirming the use of § 105(a) to allocate IRS payments to specified tax liabilities of the debtor fourteen months after confirmation of the plan of reorganization); *see generally* 2 COLLIER ON BANKRUPTCY ¶¶ 105.03-.04 (Lawrence P. King ed., 15th ed. rev. 1996, 1999, 2000, 2004, & 2005) (discussing numerous pre and postconfirmation uses of § 105(a)).

119 7 COLLIER ON BANKRUPTCY ¶ 1123.02[6] (Lawrence P. King ed., 15th ed. rev. 2004); *Energy Res.*, 495 U.S. at 548–50 (tax payment allocation provisions).

The bankruptcy courts' equitable powers are, of course, not unlimited.[120] It is well-established that § 105(a) may not be used in a manner that is inconsistent with another section of the Bankruptcy Code.[121] And the plain language of § 1123(b)(6) imposes a similar restriction on the use of that law.[122] Orders issued under § 105(a) may also be invalid if they contravene the clear dictates of federal statutes located outside the Bankruptcy Code that address bankruptcy issues.[123]

Nonetheless, the precise contours of the equitable powers granted by the Code are not clear. There are two general positions regarding the scope of § 105(a),[124] the principal statute.

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120 NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984) ("The Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization."); Architectural Bldg. Components v. McClarty (*In re* Foremost Mfg. Co.), 137 F.3d 919, 924 (6th Cir. 1998) ("[T]he district court was correct in noting that, although the bankruptcy court has broad equitable powers under 11 U.S.C. § 105(a), those powers are not unlimited."); 2 COLLIER ON BANKRUPTCY ¶ 105.01[2], at 105-7 (Lawrence P. King ed., 15th ed. rev. 2004) ("[I]t should be universally recognized that the power granted to the bankruptcy courts under section 105 is not boundless and should not be employed as a panacea for all ills confronted in the bankruptcy case.").

121 Noonan v. Sec'y of Health and Human Servs. (*In re* Ludlow Hosp. Soc., Inc.), 124 F.3d 22, 28 (1st Cir. 1997) ("The bankruptcy court may not utilize section 105(a) if another, more particularized Code provision . . . impedes the requested exercise of equitable power."); Smith v. Omni Mfg., Inc. (*In re* Smith), 21 F.3d 660, 666 (5th Cir. 1994) ("Bankruptcy courts cannot use their equity power under Section 105(a) . . . to negate substantive rights or remedies that are available" under the Code); Chiasson v. J. Louis Matherne & Assocs. (*In re* Oxford Management, Inc.), 4 F.3d 1329, 1334 (5th Cir. 1993) ("[T]he powers granted by [§ 105(a)] . . . must be exercised in a manner that is consistent with the Bankruptcy Code.") (a bankruptcy court may not employ § 105(a) to alter the priority of claims as set forth in 11 U.S.C. § 726(b) (2000)); *In re* Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 830–32 (1st Cir. 1990) ("Even as a court of equity, however, the bankruptcy court's equitable discretion [under § 105(a)] is limited and cannot be used in a manner inconsistent with the commands of the Bankruptcy Code.") (holding that a bankruptcy court may not use § 105(a) to appoint a trustee because 11 U.S.C. § 1104(d) (2000) (at the time, 11 U.S.C. § 1104(c) (1988)) expressly granted that right exclusively to the U.S. trustee); 2 COLLIER ¶ 105.01[2], at 105-7 ("Section 105 does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code . . . .").

122 11 U.S.C. § 1123(b)(6) (2000) (chapter 11 plan may "include appropriate provisions *not inconsistent with the applicable provisions of this title*") (emphasis added).

123 *See, e.g.*, Rice v. United States (*In re* Rice), 78 F.3d 1144, 1151 (6th Cir. 1996) ("[W]e believe that [a bankruptcy court's equitable] powers must be exercised in a manner consistent with federal statutes addressing the conditions under which discharges may be granted, even where those statutes are not part of the Bankruptcy Code.") (holding that 42 U.S.C. § 292f(g) (2000), which permits the *complete* discharge of Health Education Assistance Loans only where denial of such a discharge would be unconscionable, prohibited the bankruptcy court from using § 105(a) to *partially* discharge the debtor's education loans where denial of a complete discharge was not unconscionable); *see also infra* notes 561–63 and accompanying text (discussing another limit on a bankruptcy court's equitable powers that is contained in a statute not part of the Bankruptcy Code).

124 2 COLLIER ¶ 105.01[2], at 105–7.

Relying upon the Supreme Court's statement in *Norwest Bank Worthington v. Ahlers* that "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code,"[125] a number of courts have strictly construed § 105(a). According to this "narrow view," § 105(a) "does not authorize bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity."[126] Instead, the statute may only be used to enforce other, specific provisions in the Code[127]—it merely "confers

[125] 485 U.S. 197, 206 (1988).

[126] United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986) (footnote omitted); *accord* New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (*In re* Dairy Mart Convenience Stores, Inc.), 351 F.3d 86, 92 (2d Cir. 2003) (quoting the passage from *Sutton*, 786 F.2d at 1308, set forth in the text); Smith v. Omni Mfg., Inc. (*In re* Smith), 21 F.3d 660, 666 (5th Cir. 1994) ("Bankruptcy courts cannot use their equity power under Section 105(a) to fashion substantive rights and remedies not contained in the Bankruptcy Code . . . ."); *In re* Morristown & Erie R.R. Co., 885 F.2d 98, 100 (3d Cir. 1989) ("Nor does section 105(a) give the court the power to create substantive rights that would otherwise be unavailable under the Code."); 2 COLLIER ¶ 105.01[2], at 105-8 (quoting the passage from *Sutton*, 786 F.2d at 1308, set forth in the text).

[127] *See, e.g.*, New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (*In re* Dairy Mart Convenience Stores, Inc.), 351 F.3d 86, 92 (2d Cir. 2003) (concluding that § 105(a) only grants bankruptcy courts the power to enforce the specific provisions of the Bankruptcy Code) (citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)); Jamo v. Katahdin Fed. Credit Union (*In re* Jamo), 283 F.3d 392, 403–04 (1st Cir. 2002) ("The authority bestowed [under § 105] may be invoked only if, and to the extent that the equitable remedy dispensed by the court is necessary to preserve an identifiable right preserved elsewhere in the Bankruptcy Code.") (citing *Ahlers*, 485 U.S. at 206); *In re* Myrvang, 232 F.2d 1116, 1125 (9th Cir. 2000) ("Exercise of § 105 powers must be linked to another specific Bankruptcy Code provision."); Noonan v. Sec'y of Health and Human Servs. (*In re* Ludlow Hosp. Soc., Inc.), 124 F.3d 22, 28 (1st Cir. 1997) ("But since section 105 *itself* is not a source of new substantive rights, the bankruptcy court may invoke section 105(a) only if the equitable remedy utilized is demonstrably necessary to preserve a right elsewhere provided in the Code.") (citing *Ahlers*, 485 U.S. at 206); *In re* Fesco Plastics, Inc., 996 F.2d 152, 154, 156 (7th Cir. 1993) (citing *Ahlers* for the proposition that "[u]nder [§ 105(a)], a court may exercise its equitable power only as a means to fulfill some specific Code provision," and concluding that therefore a bankruptcy court may not use § 105(a) to create a new exception to the Code's prohibition on the recovery of post-petition interest by unsecured creditors); *In re* Morristown & Erie R.R. Co., 885 F.2d 98, 100 (3d Cir. 1989) ("Section 105(a) authorizes the bankruptcy court, or the district court sitting in bankruptcy, to fashion such orders as are required to further the substantive provisions of the Code."); *see also* Meltzer, *supra* note 27, at 18 (arguing that § 105(a) must be used in conjunction with another, specific provision of the Code); Boyle, *supra* note 27, at 438 (same).

It should be noted that while a majority of courts appear to have equated the "no substantive rights" language from *Sutton*, 786 F.2d at 1308, with the "tethering" requirement, other courts have used the "no substantive rights" locution in different ways. For example, in *Sutton* itself, the Fifth Circuit appeared to use the "no substantive rights" language to indicate that § 105(a) may not be used to contradict the Bankruptcy Code. *Id*. at 1308; *accord* Chiasson v. J. Louis Matherne and Assoc. (*In re* Oxford Mgmt., Inc.), 4 F.3d 1329, 1334 (5th Cir. 1993). And the expression is used in other ways as well. *See infra* notes 550, 657, and accompanying text; *see also* Bogart, *supra* note 86, at 803 (observing that courts use a "confused discourse" in applying § 105(a)).

power to issue procedural orders."[128] Orders implementing general bankruptcy policies are impermissible.[129] To illustrate, when a court enjoins a third party from prosecuting a derivative claim that was settled as part of the debtor's plan of reorganization,[130] the court is using § 105(a) to enforce § 1123(b)(3)(A), which declares that a plan of reorganization may provide for "the settlement or adjustment of any claim or interest belonging to the debtor or the estate."[131] Similarly, when a court issues an injunction barring a creditor from attempting to enforce its prior lien on property that was disposed of free and clear in a bankruptcy sale,[132] § 105(a) is employed as an adjunct to § 363(f).[133] Indeed, courts adopting the "narrow view" consider a non-debtor stay to be a § 105(a)-created extension of the general stay imposed by § 362(a).[134]

In defense of the limited approach, *Collier* observes that § 105(a) uses the term "provisions" rather than "purposes" in describing a bankruptcy court's authority "to effect the mandate of the Bankruptcy Code."[135] This suggests that § 105(a) may only be used in conjunction with another Code section "and not merely to [promote] a general bankruptcy concept or objective."[136]

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128 Plastiras v. Idell (*In re* Sequoia Auto Brokers, Ltd., Inc.), 827 F.2d 1281, 1290 (9th Cir. 1987); *accord* Alisa Loretta Pittman and Erin Hawkins, Survey, *The Controversy Surrounding the Jurisdiction of Bankruptcy Courts*, 5 J. BANKR. L & PRAC. 387, 419 (1996) ("Section 105(a) . . . is merely a procedural rather than a substantive rule . . . ."); *see also* Bird v. Carl's Grocery Co. (*In re* NWFX, Inc.), 864 F.2d 593, 595 (8th Cir. 1989) ("Nevertheless, Chapter 1 of the Bankruptcy Code is essentially procedural. It does not set out substantive rights of the parties.").

129 *See* 641 Assocs., Ltd. v. Balcor Real Estate Fin., Inc. (*In re* 641 Assocs., Ltd.), Bankr. No. 91-11234S, Adv. Nos. 93-0363S, 93-0456S, 1993 WL 332646, at *8 (Bankr. E.D. Pa. Aug. 26, 1993) ("The Debtor's contention that the relief sought would be extremely significant to, if not essential to, its successful reorganization is, in itself, not a sufficient basis for allowing invocation of § 105(a) to provide the relief sought here for several reasons. . . . Secondly, we believe that a debtor, under the Code, must achieve confirmation of a Plan *within* the confines of the Code.").

130 *See supra* notes 62–65 and accompanying text.

131 11 U.S.C. § 1123(b)(3)(A) (2000).

132 *See, e.g.*, *In re* Trans World Airlines, Inc., No. 01-0056(PJW), 2001 WL 1820325, at *8 (Bankr. D. Del. Mar. 27, 2001) (holding that a § 105(a) injunction does not "create substantive rights" when used "to carry out the effect and purpose of § 363(f)"); *In re* Dow Corning Corp., 198 B.R. 214, 245 (Bankr. E.D. Mich. 1996) (holding that bankruptcy courts may use § 105(a) to issue an injunction baring a creditor from seeking to enforce an interest in property purchased from the debtor under § 363(f) where the injunction is "necessary and appropriate to give the 'free and clear' aspect of § 363(f) meaning").

133 § 363(f).

134 *See, e.g.*, Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 979 (1st Cir. 1995) (observing that non-debtor stays "serve simply as adjuncts to the automatic stay" of § 362(a)); *see also* Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 762 (D. Utah. 1985) (indicating that non-debtor stays are only "procedural" because they expire upon confirmation of the reorganization plan).

135 2 COLLIER ON BANKRUPTCY ¶ 105.01[1] (Lawrence P. King ed., 15th ed. rev. 2004).

136 *Id.*; *accord* New England Dairies, Inc. v. Dairy Mart Convenience Stores, Inc. (*In re* Dairy Mart Convenience Stores, Inc.), 351 F.3d 86, 92 (2d Cir. 2003) (quoting 2 COLLIER ¶ 105.01[1]); Bogart, *supra* note

There is another school of thought, however, that endorses an expansive interpretation of the equitable powers available under § 105(a).[137] According to this "broad view," "certain goals of the Bankruptcy Code are implied but not stated in the statutory language," and § 105(a) grants bankruptcy courts the authority to "fill the gaps left by the statutory language" in effectuating the Code's overarching purposes.[138] As a result, courts in this camp believe that it is permissible to issue orders under § 105(a) without tying the order to a specific Code provision. The order may be linked, instead, to a general bankruptcy policy,[139] most typically, the paramount policy favoring successful reorganizations.[140] To illustrate, courts have relied upon § 105(a) to marshal assets,[141] issue provisional injunctions,[142] allow early payment of prepetition claims to creditor-vendors who threaten to withhold goods and services essential to the debtor's business operations,[143] and partially discharge student debts,[144] even though nothing in the Code expressly authorizes these orders.[145]

86, at 803–04 ("Viewed technically, section 105 permits the courts to issue orders that are necessary to carry out *provisions* of the Code. This is a more specific word than *objectives*, *goals* or *purposes*. It would seem that this word choice marks a clear, unalterable outer limit of power.").

137 2 COLLIER ¶ 105.01[2], at 105-7.

138 *Id.*

139 *See, e.g.*, Bird v. Carl's Grocery Co. (*In re* NWFX, Inc.), 864 F.2d 593, 595 (8th Cir. 1989) (explaining that the bankruptcy court's "broad equitable powers may only be used to further the *policies and provisions* of the Code") (emphasis added); Resolution Trust Corp. v. Allied Stores Corp. (*In re* Federated Dept. Stores, Inc.), 133 B.R. 886, 890 (Bankr. S.D. Ohio 1991) ("[T]his Court cannot agree with Appellants that the lack of a specific reference in the Bankruptcy Code must preclude equitable authority in the Bankruptcy Court, providing, of course, that the action does not fly in the face of unambiguous language in Title 11.").

140 *See, e.g.*, *In re* Commc'n Options, Inc., 299 B.R. 481, 482 (Bankr. S.D. Ohio 2003) ("[T]his Court believes it has inherent and express equity powers to take appropriate action necessary to protect a reorganizing debtor's potential for reorganization and the integrity of the bankruptcy system.") (ordering the appointment of a "responsible party to act for the debtor" because the debtor was using "non-productive delay tactics . . . to avoid paying its creditors" and consistently taking action "solely to protect its insiders").

141 *See supra* notes 112–14 and accompanying text.

142 *See, e.g.*, *In re* Seatco, Inc., 257 B.R. 469, 474–78 (Bankr. N.D. Tex. 2001) (holding that § 105(a) permitted the court to approve of a provisional injunction contained in the debtor's plan because, *inter alia*, the debtor's "opportunity to successfully reorganize [would be] substantially threatened" without the injunction); *In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673757, at *9-*10 (Bankr. M.D.N.C. Feb. 24, 2000) (concluding that §§ 105(a) and 1123(b)(6) confer upon bankruptcy courts sufficient authority to issue provisional injunctions and approving of the one set forth in the debtor's plan because the injunction was "'essential'" to the debtor's reorganization).

143 *See, e.g.*, *In re* Just For Feet, Inc., 242 B.R. 821, 824–25 (D. Del. 1999) ("[C]ourts have used their equitable power under section 105(a) of the Code to authorize the payment of pre-petition claims when such payment is deemed necessary to the survival of a debtor in a chapter 11 reorganization . . . ."); *In re* Wehnrenberg, Inc., 260 B.R. 468, 469 (Bankr. E.D. Mo. 2001) ("Payment of the prepetition claims of these vendors . . . is necessary to realize the possibility of a successful reorganization. Pursuant to 11 U.S.C. § 105(a) the Court may authorize the payment of prepetition claims when such payments are necessary to the

Collier ultimately favors the broad view: "Given the broad mandate to bankruptcy courts generally to reorganize debtors, to afford a fresh start to debtors and to distribute funds equitably to creditors, an expansive construction [of § 105(a)] is justified."[146]

As will be demonstrated below, the disagreement over the scope of a bankruptcy court's equitable powers is central to the debate concerning the propriety of third-party releases.[147]

B. Section 524 and the Bankruptcy Discharge

Upon emerging from bankruptcy, a debtor is generally entitled to a "discharge" of all of its liabilities, other than certain specified claims.[148]

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continued operation of the debtor."); *see generally* 2 COLLIER ON BANKRUPTCY ¶ 105.04[5][a] (Lawrence P. King ed., 15th ed. rev. 2004) (discussing the split in the courts over the "doctrine of necessity" or "necessity of payment doctrine" and concluding that the doctrine's continued viability is questionable).

[144] *See, e.g.*, Kapinos v. Graduate Loan Ctr. (*In re* Kapinos), 243 B.R. 271, 275–77 (W.D. Va. 2000) (concurring with the authorities holding that courts may use § 105(a) to *partially* discharge student debts that are non-dischargeable *in full* in the absence of undue hardship under § 523(a)(8)).

[145] *Kapinos*, 243 B.R. at 275 ("The language of § 523(a)(8) does not explicitly authorize *partial discharge*.") (emphasis added); *In re* Just For Feet, Inc., 242 B.R. 821, 824–25 (D. Del. 1999) (noting that the *doctrine of necessity* or *necessity of payment doctrine* "was not codified in the Bankruptcy Code"); Century Brass Prod., Inc. v. Colonial Bank (*In re* Century Brass Prod., Inc.), 95 B.R. 277, 279 (D. Conn. 1989) ("A right in bankruptcy to obtain the *marshalling of assets* is not expressly provided in the Bankruptcy Code. Nonetheless we will assume, for purposes of argument only, that in an appropriate case the Bankruptcy Court, as a court of equity, could order the marshalling of assets for the benefit of a creditor pursuant to 11 U.S.C. § 105(a).") (emphasis added); *cf. In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673757, at *9-*10 (Bankr. M.D.N.C. Feb. 24, 2000) (relying upon §§ 105(a) and 1123(b)(6), alone, to issue a *provisional injunction*).

[146] 2 COLLIER ¶ 105.01[2], at 105–8; *accord id.* at 105–9 ("The equitable origins of the bankruptcy power suggest substantial leeway to tailor solutions to meet the diverse problems facing bankruptcy courts. Section 105 gives the bankruptcy court the power to fill in gaps [in the Code] and further the statutory mandates of Congress in an efficient manner."); *see also* Bogart, *supra* note 86, at 803 ("It is unclear which reading is the dominant view."); *id.* at 803 n.38 ("In truth, although one approach to section 105 powers of bankruptcy courts may gain strength at different points over time, both expansive and restrictive applications of the provision have existed from the Code's inception.").

As the material in the text should make clear, the debate over the scope of a bankruptcy court's equitable powers has focused almost exclusively on § 105(a). Section 1123(b)(6) is seldom mentioned. This is not terribly surprising. Section 105(a) is generally considered to be the primary equitable statute in the Code. *See supra* note 8. For purposes of this Article, I shall treat § 1123(b)(6) as conferring powers no broader than § 105(a).

[147] *See infra* Part III.

[148] *See* 11 U.S.C. §§ 523, 524, 727, 944, 1141(d) (2000). Individual debtors reorganizing under chapter 13 are generally not entitled to a discharge until they complete all payments under their plan of reorganization. *See* § 1328(a)-(b). And the same is now true for individuals filing under chapter 11. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 321(d)(2), 119 Stat. 95 (adding 11 U.S.C. § 1141(d)(5)(A)-(B)); *id.* § 330(b), 119 Stat. 101 (adding 11 U.S.C. § 1141(d)(5)(C)).

Section 524 of the Code sets forth the precise impact of a discharge.[149] Pursuant to that statute, the discharge of a debt "voids any judgment" based on the claim[150] and "operates as an injunction" against any attempt to collect upon the claim from the debtor personally.[151]

Section 524(e) contains an important limitation on the scope of the discharge. It provides that, aside from a minor exception, 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."[152] Courts have universally interpreted this language to mean that the discharge of a debtor does not, by itself, affect the liability of a codebtor on a discharged obligation.[153] In essence, then, a bankruptcy discharge "does not extinguish the debt itself, but merely releases the debtor from personal liability for the debt."[154] This leaves creditors free to obtain any deficiency from a co-obligor.[155] Without § 524(e),

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[149] 4 COLLIER ON BANKRUPTCY ¶ 524.01, at 524-14.5 (Lawrence P. King ed., 15th ed. rev. 2005); *see generally* § 524. Section 524 applies to all cases under chapters 7, 11, 12, and 13. § 103.

[150] § 524(a)(1).

[151] § 524(a)(2).

[152] § 524(e). Section 524(e)'s legislative history "does little more than restate the section." Lewis, *supra* note 27, at 164; *see* S. REP. No. 95-989, at 81, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5867 ("Subsection [(e)] provides the discharge of the debtor does not affect co-debtors or guarantors."). The legislative history thus "offers little interpretive insight." Boyle, *supra* note 27, at 424.

[153] *See e.g.*, Zerand-Bernal Group, Inc. v. Cox, 23 F.3d 159, 163 (7th Cir. 1994) (Posner, C.J.) ("[D]ischarge operates as an injunction, but only against suing the debtor; the statute is explicit on this point, 11 U.S.C. § 524(e) . . . ."); First Fidelity Bank v. McAteer, 985 F.2d 114, 118 (3d Cir. 1993) ("[Section 524(e)] assures creditors that the discharge of a debtor will not preclude them from collecting the full amount of a debt from co-debtors or other liable parties."); FDIC v. Municipality of Ponce, 904 F.2d 740, 747–49 (1st Cir. 1990) (holding that § 524(e) preserves the liability "of a guarantor on the obligations of a debtor whose debts have been discharged in bankruptcy"); Sandy Ridge Dev. Corp. v. La. Nat'l Bank (*In re* Sandy Ridge Dev. Corp.), 881 F.2d 1346, 1351 (5th Cir. 1989) ("A discharge in bankruptcy will simply not affect the liability of a guarantor."); Spiers Graff Spiers v. Menarko (*In re* Spiers Graff Spiers), 190 B.R. 1001, 1011 (Bankr. N.D. Ill. 1996) ("[Section 524(e)] at least stands for the proposition that, unless rights of creditors against third parties are expressly addressed in the plan, a plan of reorganization and the resulting discharge of a debtor does not affect rights that creditors may have against third party non-debtors."); *In re* Dollar Assoc., 172 B.R. 945, 951 (Bankr. N.D. Cal. 1994) (holding that under § 524(e) "[c]onfirmation of a plan cannot discharge a non-debtor co-obligor"); *see also* Boyle, *supra* note 27, at 421–22 ("[C]ourts have unanimously held that where a Chapter 11 plan of reorganization is silent on a non-debtor's liability, § 524(e) applies to bar the discharge of the non-debtor."); Han, *supra* note 27, at 565 & n.114 ("Where a plan does not expressly purport to release the liability of a nondebtor, courts have consistently interpreted section 524(e) as preserving the liability of that nondebtor on the debtor's obligations.") (collecting authorities).

[154] Houston v. Edgeworth (*In re* Edgeworth), 993 F.2d 51, 53 (5th Cir. 1993); *see also* § 524(a)(1), (2), discussed *supra* notes 150–51 and accompanying text.

[155] Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 600–01 (10th Cir. 1990) (noting that numerous courts have confirmed that "creditors whose claims have been discharged vis-à-vis the bankrupt [may] recover on the same claims from third parties"), *modified*, 932 F.2d 898 (10th Cir. 1991); Han, *supra* note 27, at 565 ("Consequently, the creditor may proceed

the discharge of the debtor might automatically extinguish claims against guarantors and other codebtors under the common law of suretyship, which provides that the release of a primary obligor discharges any party that is secondarily liable.[156]

Section 524(e) had several precursors in the Bankruptcy Act.[157] The primary statute was section 16 which stated: "[T]he 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."[158] Similarly, section 4(b) of the Act provided: "[T]he bankruptcy of a corporation shall not release its officers, the members of its board of directors or trustees or of similar controlling bodies, or its stockholders or members, as such, from any liability under the laws of a State or of the United States."[159] Finally, section 5(j) stated: "[T]he discharge of a partnership shall not discharge the individual general partners thereof from the partnership debts."[160]

Some courts interpreted section 16 to bar non-debtor releases.[161] However, under the Bankruptcy Act, courts generally held that third-party releases were invalid on jurisdictional grounds,[162] and thus few courts had occasion to apply sections 16, 4(b), and 5(j) to such releases.[163]

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against the debtor's co-debtor or guarantors to collect an unpaid portion of the original debt, to the extent a creditor has not received full payment of its original debt from a distribution in bankruptcy.").

156 Brubaker, *supra* note 27, at 971–72 & n.46 (citing RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §§ 39-44 & intro. note, at 167 (1996)); *see also In re* Digital Impact, Inc., 223 B.R. 1, 10 (N.D. Okla. 1998) ("[S]ection 524(e) was intended to insure that co-debtors or guarantors . . . are not automatically released from the debtor or guaranty upon the discharge of a debtor . . . .") (emphasis removed).

157 Bankruptcy Act of 1898, Pub. L. No. 696, 30 Stat. 544 (repealed 1978).

158 Act of July 1, 1898, ch. 541, § 16, 30 Stat. 550 (formerly codified at 11 U.S.C. § 34 (1976)).

159 Act of June 22, 1938, ch. 575, § 4(b), 52 Stat. 845 (formerly codified at 11 U.S.C. § 22(b) (1976)).

160 Act of June 22, 1938, ch. 575, § 5(j), 52 Stat. 845 (formerly codified at 11 U.S.C. § 23(j) (1976)). It should be noted that at least one commentator has suggested that § 524(e) was meant to reenact only section 16 and not sections 4(b) and 5(j). *See* Feldstein, *supra* note 27, at 32. Other commentators disagree. *See* Lewis, *supra* note 27, at 164 (concluding that § 524(e) is based upon both section 16 and section 4(b) of the Act); *see also* Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985) (stating that § 524(e) is "a reenactment of Section 16 of the 1898 Act," but also citing section 4(b) in construing § 524(e)).

161 *See, e.g.*, Union Carbide v. Newboles, 686 F.2d 593, 595 (7th Cir. 1982) (holding that under section 16 creditor approval cannot effectuate a non-debtor release); R.I.D.C. Indus. Dev. Fund v. Synder, 539 F.2d. 487, 490 n.3 (5th Cir. 1977) (invalidating a non-debtor release in the debtor's plan because "[t]he bankruptcy court can affect only the relationships of debtors and creditor. It has no power to affect the obligations of guarantors.")

162 *See* Brubaker, *supra* note 27, at 1053 ("Because courts under the 1898 Act, as a rule, refused to enjoin suits between non-debtors, even temporarily, it is not at all surprising that these courts also rejected occasional efforts to obtain permanent non-debtor releases through a plan of reorganization . . . ."); *id.* at 1053 n.353 (collecting authorities holding that bankruptcy courts did not have jurisdiction to grant non-debtor releases); *id.*

III. THE SPLIT IN THE COURTS OVER THE PROPRIETY OF NON-DEBTOR RELEASES

This Part summarizes the judicial debate over the validity of non-debtor releases. It also discusses some arguments raised by commentators. Subpart A addresses the primary anti-release authorities. Subpart B discusses the pro-release case law.[164] Subpart C revisits the anti-release position to present a final argument best considered after the discussion of the pro-release decisions. Finally, Subpart D considers, and rejects, attempts by judges and scholars to reconcile the two lines of authority.

A. *The Anti-Release Cases*

Courts holding that non-debtor releases are impermissible under the Bankruptcy Code focus primarily on § 524(e). They maintain that the statute's express language bars such releases and that the policies underlying § 524(e) bolster this interpretation.

The Ninth Circuit is the leading proponent of the view that third-party releases are invalid under § 524(e). The court first articulated this position in *Underhill v. Royal*.[165] There, the debtor's plan of reorganization contained a provision that purportedly released the debtor's founder (Royal) and other related parties from all claims arising from certain notes executed by the debtor.[166] The persons that had invested in the notes were classified as unsecured creditors in the bankruptcy.[167] A majority of them voted in favor of the plan.[168] However, the Underhills dissented, specifically objecting to the

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at 1051–52 & n.352 (observing that under the Bankruptcy Act courts generally held that they did not have jurisdiction to grant non-debtor stays and collecting authorities).

163 And some of the courts that relied upon § 16 did so only in support of a jurisdictional argument. *See* Weber v. Diversey Bldg. Corp. (*In re* Diversey Bldg. Corp.), 86 F.2d 456, 456–58 (7th Cir. 1936) (holding that the bankruptcy judge did not have jurisdiction to confirm a plan releasing a guarantor of the debtor or to issue a permanent injunction enforcing the plan and concluding that its jurisdictional argument was "supported by Section 16 of the Bankruptcy Act"); *In re* Nine N. Church St., Inc., 82 F.3d 186, 188–89 (2d Cir. 1936).

164 Some courts categorize the decisions regarding non-debtor releases into three camps—pro-release, anti-release, and pro-voluntary release. *See, e.g.*, *In re* Dow Corning Corp., 255 B.R. 445, 476–78 (E.D. Mich. 2000) (adopting this classification system), *rev'd on other grounds*, 280 F.3d 648 (6th Cir. 2002); *see also* Meltzer, *supra* note 27, at 1 (same). As noted in the taxonomy section above, this Article's focus is on *involuntary* third-party releases. *See supra* Part I.A. Accordingly, this Article classifies as "anti-release" any court holding that *only voluntary* non-debtor releases are permissible under the Code.

165 769 F.2d 1426 (9th Cir. 1985).

166 *Id.* at 1429–30.

167 *Id.* at 1429.

168 *Id.* at 1430.

release.[169] The bankruptcy court confirmed the plan, but only pursuant to a stipulation that the validity of the release would be determined by the district court.[170] That court ruled that the release was unenforceable and ultimately entered judgment against Royal on the Underhills' cause of action for securities law violations relating to the notes.[171]

Royal appealed to the Ninth Circuit where he contended that the release barred the Underhills' claims against him.[172] He also argued that the provision was valid because the investors approved it when they voted in favor of the plan.[173] The Ninth Circuit disagreed.

The court explained that under § 524(e) the discharge of a debtor generally "will not discharge the liabilities of co-debtors or guarantors."[174] That statute, and its precursors in the Bankruptcy Act, "underscore the limitations on the Bankruptcy Court."[175] Moreover, a debtor is discharged by "operation of the bankruptcy laws, not by consent of the creditors."[176] From this, the court summarily concluded that

> the bankruptcy court has no power to discharge the liabilities of a nondebtor pursuant to the consent of the creditors as part of a reorganization plan. The broad language of § 524(e), limiting the scope of a discharge so that it "does not affect the liability of any other entity," encompasses this result.[177]

The Ninth Circuit revisited the issue of non-debtor releases in *In re American Hardwoods, Inc.*[178] The debtor in that case, American Hardwoods, requested that the bankruptcy court issue a permanent injunction under § 105(a) barring Deutsche Credit Corporation from enforcing a state court judgment against the

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169 *Id.* The Ninth Circuit's opinion does not explicitly address whether the Underhills would have received full compensation for their securities law claims against Royal under the debtor's chapter 11 plan. *Id.* at 1429–30.

170 *Id.* at 1430.

171 *Id.*

172 *Id.* at 1431–32.

173 *Id.* at 1432.

174 *Id.*

175 *Id.*

176 *Id.* (citing Union Carbide Corp. v. Newboles, 686 F.2d 593, 595 (7th Cir. 1982)).

177 *Id.* (quoting 11 U.S.C. § 524(e) (2000)).

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

Keelers, shareholders of the debtor and guarantors of its debt to Deutsche.[179] The bankruptcy court found that if Deutsche pursued its judgment, the company would execute on the Keelers' stock in American Hardwoods, destroying the Keelers' incentive to operate the debtor.[180] Under this scenario, the reorganization would likely fail.[181] Nonetheless, the bankruptcy court denied the motion for a permanent injunction,[182] and the district court affirmed.[183]

On appeal, the Ninth Circuit addressed "whether section 105 invests the court with power to order the permanent relief requested by American [Hardwoods]."[184] The court acknowledged that § 105(a) endows bankruptcy courts "with general equitable powers," but ruled that the statute "does not authorize relief inconsistent with more specific law."[185] Then, after quoting the holding in *Underhill*,[186] the Ninth Circuit concluded that "[s]ection 524(e) . . . limits the court's equitable powers under section 105 to order the discharge of the liabilities of nondebtors, such as the Keelers."[187]

The Tenth Circuit followed *American Hardwoods* in *In re Western Real Estate Fund, Inc.*, holding that § 524(e) prohibits any permanent injunction "extended post-confirmation that effectively relieves the non-debtor from its own liability to the creditor."[188] In reaching this conclusion, the Tenth Circuit explained that § 524(e) evinces a Congressional policy not to extend the benefits of a discharge to non-debtors because these parties have not "invoked

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179 *Id.* at 622. American Hardwood's plan clearly did not provide payment in full to Deutsche on the claims guaranteed by the Keelers. If it had, Deutsche would not have needed to file a separate lawsuit against the Keelers seeking to enforce the guaranty.

180 *Id.*

181 *Id.*

182 *Id.*

183 *Id.* at 623.

184 *Id.* at 624.

185 *Id.* at 625.

186 *Id.* (quoting Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985) (holding that a bankruptcy court has no power to discharge the liabilities of non-debtors)).

187 *Id.* at 626. It should be noted that the Ninth Circuit found additional support for its conclusions in § 524(a). 11 U.S.C. § 524(a) (2000). This argument will be addressed in Part V, *see infra* notes 633–49 and accompanying text, because nearly all subsequent anti-release authorities ignored § 524(a), focusing solely on § 524(e), *see infra* notes 188–204 and accompanying text.

188 Landsing Div. Props. v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 601–02 (10th Cir. 1990) (expressly following *Am. Hardwoods*, 885 F.2d 621). The party that the debtor sought to enjoin was not scheduled to receive payment in full on its claim under the debtor's plan. *W. Real Estate Fund*, 922 F.2d at 598 ("The bankruptcy court permanently enjoined Abel from further prosecution of his state action against PSO, conditioned only on timely payment of the *diminished* fee claim allowed against [the debtor].") (emphasis added).

and submitted to the bankruptcy process."[189] This policy is further reflected in the fact that a bankruptcy discharge does not extinguish debts; it "merely releases the debtor from personal liability," leaving co-obligors responsible for any deficiencies.[190] But a non-debtor release effectively discharges the debt of a third party,[191] contrary to Congressional intent. Section 524(e) thus bars this type of relief.[192] And since the equitable powers granted by § 105(a) "may not be exercised in a manner that is inconsistent with other, more specific provisions of the Code," that statute does not provide authority for non-debtor releases.[193]

Numerous decisions have either adopted the holdings of *Underhill*, *American Hardwoods*, and *Western Real Estate Fund* or reached the same conclusion regarding the scope of § 524(e).[194] Some of these cases, as well as

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[189] *Id.* at 600.

[190] *Id.* (internal quotation marks omitted); *see also* Boyle, *supra* note 27, at 437 ("Section 524(a) restricts a discharge to debts that are [a] 'personal liabilit[y] of the debtor.'") (quoting § 524(a)(1)-(2)).

[191] *W. Real Estate Fund*, 922 F.2d at 600. The plan did not pay the creditor's claim in full, *id.* at 598, so the permanent injunction was an actual release.

[192] *Id.* at 602.

[193] *Id.* at 601.

[194] For the decision in the First Circuit, see *In re* Boston Harbor Marina Co., 157 B.R. 726, 729–31 (Bankr. D. Mass. 1993) (§ 524(e) bars non-debtor releases; invalidating an actual release).

For the decision in the Second Circuit, see *In re* Texaco, Inc., 84 B.R. 893, 900 (Bankr. S.D.N.Y. 1988) (stating in dicta that § 524(e) bars non-debtor releases), *appeal dismissed by* 92 B.R. 38 (S.D.N.Y. 1988); *see also* Keene Corp. v. Acstar Ins. Co. (*In re* Keene Corp.), 162 B.R. 935, 946–47 (Bankr. S.D.N.Y. 1994) (ruling that § 524(e) prohibits bankruptcy court orders that prevent creditors from enforcing disallowed and subordinated claims against guarantors, sureties and escrows). But see *infra* note 275 for authorities establishing that non-debtor releases are permissible in the Second Circuit.

For the decisions in the Third Circuit, see *In re* Arrowmill Dev. Corp., 211 B.R. 497, 500, 504–06 (Bankr. D.N.J. 1997) (§ 524(e) expressly prohibits non-debtor releases, displacing any authority in § 105(a) to grant such relief; striking a non-debtor discharge); *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 66–67 (Bankr. W.D. Pa. 1994) (§ 524(e) bars non-debtor releases, preventing the use of § 105(a) to issue such relief; invalidating an actual release); *In re* W. Coast Video Enters., Inc., 174 B.R. 906, 911 (Bankr. E.D. Pa. 1994) (§ 524(e) only permits consensual non-debtor releases); *In re* Swedeland Rd. Corp., No. 91-11851S, 1992 WL 111112, at *2 (Bankr. E.D. Pa. May 19, 1992) (§ 524(e) bars non-debtor releases; striking a release of a creditor's claim against a guarantor); Mellon Bank v. M.K. Siegel, 96 B.R. 505, 506 (E.D. Pa. 1989) (§ 524(e) prohibits non-debtor releases; invalidating an actual release); *In re* Elsinore Shore Assoc., 91 B.R. 238, 246–52 (Bankr. D.N.J. 1988) (§ 524(e) bars non-debtor releases; invalidating three non-debtor discharges); *see also In re* Monroe Well Serv., Inc., 80 B.R. 324, 334 (Bankr. E.D. Pa. 1987) (stating in dicta that involuntary non-debtor releases violate § 524(e)). In *Gillman v. Continental*, the Third Circuit Court of Appeals conducted a sustained analysis of the judicial debate over the propriety of non-debtor releases. *See* Gillman v. Cont'l Airlines (*In re* Cont'l Airlines), 203 F.3d 203, 211–13 (3d Cir. 2000). The court's ultimate conclusion is somewhat confusing. It explained that "we need not establish our own rule regarding the conditions under which non-debtor releases and permanent injunctions are appropriate or permissible" because the non-debtor release there did "not pass muster under even the most flexible tests for the validity of non-debtor releases." *Id.* at 214. Thus, the court continued, the third-party release fell "squarely into the section 524(e) prohibition."

Id. at 217. It appears the Third Circuit was taking the view that § 524(e) generally bars non-debtor releases, but that the court is open to the possibility that there are exceptions to this prohibition where the factors set forth in the main pro-release cases are met. *See In re* PWS Holding Corp., 228 F.3d 224, 247 (3d Cir. 2000) ("In [*Continental*], we held that a plan that enjoined plaintiffs' actions against Continental's directors and officers violated § 524(e) . . . . We did not treat § 524(e) as a per se rule barring any provision in a reorganization plan limiting the liability of third parties."); *see also infra* note 277 and accompanying text.

For the decisions in the Fifth Circuit, see Feld v. Zale Corp. (*In re* Zale), 62 F.3d 746, 760 (5th Cir. 1995) ("Section 524[(e)] prohibits the discharge of debts of non-debtors," and thus § 105(a) may not be used to grant non-debtor releases); Simmons v. 22 Acquisition Corp., No. Civ.A. 2:05-CV-169, 2005 WL 3018726, at *2 (E.D. Tex. Nov. 10 2005) (same) (quoting *Zale*, 62 F.3d at 760); *see also In re* General Homes Corp., 134 B.R. 853, 861 (Bankr. S.D. Tex. 1991) (stating, in dicta, that a chapter 11 plan may not release any claims against non-debtors that are not property of the estate); *In re* B.W. Alpha, Inc., 89 B.R. 592, 595–96 (Bankr. N.D. Tex. 1988) (stating, in dicta, that § 524(e) would have barred confirmation of the plan if the non-debtor release had not been removed), *aff'd*, 100 B.R. 831 (N.D. Tex. 1988); *In re* U.S. Brass Corp., 194 B.R. 420, 422–23 (Bankr. E.D. Tex. 1996) (summarizing a previous ruling that courts may not enjoin direct claims against non-debtors).

For the decisions in the Sixth Circuit, see *In re* Future Energy Corp., 83 B.R. 470, 485–86 (Bankr. S.D. Ohio 1988) (§ 524(e) bars even consensual non-debtor releases; invalidating a non-debtor discharge); *In re* Scranes, Inc., 67 B.R. 985, 989 (Bankr. N.D. Ohio 1986) (same); *In re* Eller Bros., Inc., 53 B.R. 10, 11–12 (Bankr. M.D. Tenn. 1985) (§ 524(e) prohibits non-debtor releases; striking a release of a guarantor even though the plan provided for payment in full on the creditor's claim). But see *infra* note 275 for authorities establishing that non-debtor releases are permissible in the Sixth Circuit.

For the decisions in the Seventh Circuit, see *In re* Original IFPC Shareholders, Inc., 317 B.R. 738, 746–48 (Bankr. N.D. Ill. 2004) (holding that § 524(e) bars third-party releases and nullifying both channeling and actual releases in the debtor's plan); *In re* Spiers Graff Spiers v. Menarko (*In re* Spiers Graff Spiers), 190 B.R. 1001, 1012 (Bankr. N.D. Ill. 1996) (citing the leading § 524(e) cases in support of its conclusion that the "authority to enjoin post-confirmation actions against non-debtors under § 105 must . . . be limited to the period in which the Plan is consummated . . . [because] injunctions should not be used to give permanent relief to non-debtors from their possible liability to creditors") (denying a post-confirmation request for a permanent injunction that would have enjoined a creditor of the debtor from prosecuting an action against two non-debtors); *In re* Envirodyne, Indus., Inc., 174 B.R. 955, 962 (Bankr. N.D. Ill. 1994) (non-debtor releases are proper only "if they are consensual and non-coercive"); United Model Distrib., Inc. v. Ry. Express Agency, Inc. (*In re* United Model Distrib., Inc.), No. 90 B 24281, No. 91 A 1120, 1992 WL 503595, at *3 (Bankr. N.D. Ill. May. 1, 1992) ("The authority to enjoin post-confirmation actions against non-debtors under § 105 must also be limited to the period in which the Plan is consummated. . . . Indeed, an injunction that extended beyond this time would merely serve to insulate the non-debtor from his liability to the creditors, and courts may not issue permanent injunctions which effectively relieve non-debtors from their possible liability to creditors.") (citing Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 621 (9th Cir. 1989) and Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 601–02 (10th Cir. 1990), *modified*, 932 F.2d 898 (10th Cir. 1991)).

For the decision in the Eighth Circuit, see *In re* Bennett Paper Corp., 68 B.R. 518, 519–20 (Bankr. E.D. Mo. 1986) (§ 524(e) bars a chapter 11 plan from containing a non-debtor release).

For the decisions in the Ninth Circuit, see Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1401–02 (9th Cir. 1995) (§ 524(e) prohibits non-debtor releases; invalidating a non-debtor discharge); Sun Valley Newspapers, Inc. v. Sun World Corp. (*In re* Sun Valley Newspapers, Inc.), 171 B.R. 71, 76 (B.A.P. 9th Cir. 1994) (§ 524(e) bars non-debtor releases; invalidating a hybrid provision that extinguished prepetition claims of creditors against non-debtors without providing for payment in full under the plan); Seaport Automotive Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts, Inc.), 113 B.R. 610, 614–16 (B.A.P. 9th Cir. 1990) (§ 524(e) prohibits any plan provision that "affects the liability of . . . co-debtors") (striking a provisional injunction that merely stayed collection efforts against several scholarly articles, have elaborated as follows on the policy arguments proffered by the Tenth Circuit.

The Bankruptcy Code limits creditors to a proportionate distribution from the estate and prohibits, through the discharge, any further attempt to collect from the debtor.[195] To obtain this draconian relief, the debtor must grant the bankruptcy court control over all of its assets.[196] Acceptance of this burden, combined with the debtor's inability to satisfy its liabilities in full, provides the justification for a bankruptcy court's extraordinary power to force creditors to accept partial payment.[197] In other words, because extinguishing any portion of a claim is an extreme remedy, it is properly granted only to those who submit fully to the bankruptcy process.[198] Interpreting § 524(e) to bar non-

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non-debtors for five years after confirmation of the plan and did not release the codebtors from liability); *In re* Keller, 157 B.R. 680, 682, 686 (Bankr. E.D. Wash. 1993) (§ 524(e) bars non-debtor releases; invalidating a channeling release); *see also* Billington v. Winograde (*In re* Hotel Mt. Lassen, Inc.), 207 B.R. 935, 940–41 (Bankr. E.D. Cal. 1997) (stating the general rule that § 524(e) bars non-debtor releases, but noting that there was no such provision at issue in the case).

For the decisions in the Eleventh Circuit, see *In re* Davis Broad., Inc., 176 B.R. 290, 291–92 (M.D. Ga. 1994) (§ 524(e) bars a bankruptcy court from "affecting" the liability of a guarantor in any way, including through a provisional injunction staying creditors' legal actions against certain third parties pending execution of the plan) ("It is thus clear that this is a post-confirmation injunction and violates 11 U.S.C. Section 524(e) and accordingly exceeds the power and authority of the Bankruptcy Court because the section referred to prohibits release or a post-confirmation stay of the obligations of non-party guarantors. . . . Of course, the liability of a guarantor is 'affected' regardless of whether it is released or, as in this case, stayed for a long period of time."); *In re* L.B.G. Props., Inc., 72 B.R. 65, 66 (Bankr. S.D. Fla. 1987) (§ 524(e) bars non-debtor releases; invalidating a provision that appears to only release those claims paid in full under the plan); Hat-Hanseatische Anlage v. Sago Palms Joint Venture (*In re* Sago Palms Joint Venture), 39 B.R. 9, 9 (Bankr. S.D. Fla. 1984) (§ 524(e) prohibited the non-debtor release contained in the plan to the extent the provision extinguished "the personal liability of either [non-debtor] for any debt beyond the amounts actually paid by the debtor upon such liability . . . ."); *see also* PNC Bank, NA v. Park Forest Dev. Corp. (*In re* Park Forest Dev. Corp.), 197 B.R. 388, 397 (Bankr. N.D. Ga. 1996) (explaining in dicta that § 524(e) bars non-debtor releases).

For commentators adopting this view, see Starr, *supra* note 27, at 487 (concluding that § 524(e) prohibits non-debtor releases); Boyle, *supra* note 27, at 422, 436 (same).

[195] *In re* Arrowmill Dev. Corp., 211 B.R. 497, 506 (Bankr. D.N.J. 1997) (quoting Starr, *supra* note 27, at 498).

[196] *Id.* (quoting Starr, *supra* note 27, at 498); *accord* Brubaker, *supra* note 27, at 997.

[197] *Arrowmill Dev. Corp.*, 211 B.R. at 506 (quoting Starr, *supra* note 27, at 498).

[198] *Id.* at 503 ("Since a discharge is an extreme remedy . . . it is a privilege reserved for those entities which file a petition under the bankruptcy code and abide by its rules."); *see also* Seaport Automotive Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts), 113 B.R. 610, 614 (B.A.P. 9th Cir. 1990) (concluding that the provisional injunction in the plan "challenges a basic tenet of the Code that Chapter 11 cases generally are for the protection of the debtor only and not to protect the debtor's principals or co-debtors"); *In re* Keller, 157 B.R. 680, 685 (Bankr. E.D. Wash. 1993) (quoting the language from *Rohnert* in the last parenthetical in support of its holding that a channeling release was invalid); *cf.* Feld v. Zale Corp. (*In re* Zale), 62 F.3d 746, 757 n.28 (5th Cir. 1995) (explaining that one policy of the Code is that "bankruptcy should benefit only the debtor" in justifying its conclusion that jurisdiction did not extend to certain non-debtor claims).

debtor releases is consistent with this general policy that a party wishing to obtain the privileges of bankruptcy must accept its obligations.[199]

An alternative construction permits third parties to obtain one of the key benefits offered by the Code—a release of liability—without having to comply with the Code's accompanying duties.[200] Non-debtors are able to "savor the sweet without having to taste the sour."[201] And since third-party releases extinguish claims without providing the non-debtor's obligees the full protection the Code grants to creditors of the debtor, they upset "the careful balance between . . . debtor's rights and . . . creditor's rights that Congress struck in creating the bankruptcy system."[202]

In sum, § 524(e) embodies a critical policy of the Code—"the protection of rights of creditors to pursue persons and entities who are jointly liable with a debtor [and] who have not assumed the burdens of a debtor under the Bankruptcy Code."[203] The statute therefore prohibits non-debtor releases.[204]

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199 Starr, *supra* note 27, at 487; *see also* Boyle, *supra* note 27, at 422–23 ("Moreover, precluding non-debtor discharges ensures that only parties that have submitted to the jurisdiction of the bankruptcy court will receive the benefits intended under the Code.")

200 Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 761–62 (D. Utah. 1985) (holding that only non-debtor stays are valid under the Bankruptcy Code—a court may not enjoin a creditor from pursuing a non-debtor after confirmation of the debtor's plan of reorganization).

201 *Id.* at 761; *see also* Brubaker, *supra* note 27, at 998 ("Through non-debtor releases, however, many non-debtors are released without making any contribution whatsoever toward satisfaction of the released claims.").

202 *A.J. Mackay*, 50 B.R. at 761; *accord* Boyle, *supra* note 27, at 439 ("Congress . . . could not have contemplated that the bankruptcy code would have a significant impact upon the relationship between creditors and non-debtors."); *see also* Brubaker, *supra* note 27 at 987 (concluding that non-debtor releases can corrupt the integrity of the class voting process)

203 *In re* Digital Impact, Inc., 223 B.R. 1, 10 (N.D. Okla. 1998); *see also* Mellon Bank v. M.K. Siegel, 96 B.R. 505, 506 (E.D. Pa. 1989) ("While the bankruptcy Code expressly alters the contractual obligations of the bankrupt, it does not contemplate the same effect on the obligations and liabilities of third parties . . . ."); Starr, *supra* note 27, at 487 ("Section 524(e) clearly embodies the policy of the Bankruptcy Code to discharge the debtor but not to release from liability third parties which are liable with the debtor.").

204 In 1994, Congress added a new paragraph to § 524 that expressly allows for non-debtor releases in asbestos cases when a series of complicated requirements are satisfied. 11 U.S.C. § 524(g) (2000); Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1402 n.6 (9th Cir. 1995). Some courts and at least one commentator have argued that this amendment lends support to the view that § 524(e) prohibits non-debtor releases. *Id.* at 1402 n.6 ("A recent amendment to the Bankruptcy Code buttresses our conclusion that § 524(e) does not permit bankruptcy courts to release claims against non-debtors."); *In re* Salem Suede, Inc., 219 B.R. 922, 937 (Bankr. D. Mass. 1998) (§ 524(g) "suggests that 524(e) precludes issuance" of channeling non-debtor releases); Meltzer, *supra* note 27, at 31–33. According to this view, § 524(g) demonstrates that Congress believes that § 524(e) bars non-debtor releases. Meltzer, *supra* note 27, at 32–33. If Congress thought otherwise, there would have been no need to add paragraph (g). *Id.* In addition, since Congress has explicitly approved of non-debtor releases in only the asbestos context, it is reasonable to conclude that bankruptcy courts lacks the power to grant such releases in other circumstances. *Lowenschuss*, 67 F.3d at

Some courts have relied upon an alternative ground in ruling that non-debtor releases are invalid. Instead of finding that § 524(e) is a bar, these courts hold that third-party releases are simply beyond the equitable powers granted by § 105(a). *In re Digital Impact, Inc.* is illustrative.[205] There, the court embraced the narrow view of § 105(a), concluding that the statute may

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1402 n.6 ("That Congress provided explicit authority to bankruptcy courts to issue injunctions in favor of the third parties in an extremely limited class of cases reinforces the conclusion that § 524(e) denies such authority in other, non-asbestos cases."); Meltzer, *supra* note 27, at 32 ("[H]ad Congress intended bankruptcy court to have greater leeway to effect releases of nondebtor parties, particularly in cases not involving asbestos, it could have said so."). Finally, because § 524 now expressly addresses non-debtor releases, courts should not look to other portions of the Code to find the authority to grant such relief. The specific subparagraphs of 524(g) displace any general provisions contained elsewhere in the Code.

This argument contains fatal weaknesses. Most significantly, when Congress amended § 524, it included a special "Rule of Construction," which provides that "[n]othing in [524(g)] . . . shall be construed to modify, impair, or supercede 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 (uncodified). As the legislative history explains, § 111(b)

> make[s] clear that the special rule being devised for the asbestos claim/trust injunction mechanism is not intended to alter any authority bankruptcy courts may already have to issue injunctions in connection with a plan [of] reorganization. . . . The Committee expresses no opinion as to how much authority a bankruptcy court may generally have under its traditional equitable powers to issue an enforceable injunction [outside the asbestos context]. The Committee has decided to provide explicit authority in the asbestos area because of the singular cumulative magnitude of the claims involved.

See 140 CONG. REC. H10 766 (Daily ed. Oct 4 1994) (Remarks of Rep. Brooks). Several courts and commentators have cited the Rule of Construction in concluding that § 524(g) does not bolster the anti-release position. *See, e.g.*, *In re* Dow Corning Corp., 244 B.R. 721, 739 (Bankr. E.D. Mich. 1999) (holding that § 524(g) does not support the conclusion that non-debtor releases are invalid under the Code because of the Rule of Construction), *rev'd on other grounds*, 255 B.R. 445 (E.D. Mich. 2000), *rev'd in part*, 280 F.3d 648 (6th Cir. 2002); Greenblatt v. Richard Potasky Jeweler, Inc. (*In re* Richard Potasky Jeweler, Inc.), 222 B.R. 816, 827 n.19 (S.D. Ohio 1998) (same); 4 COLLIER ON BANKRUPTCY ¶ 524.07[2], at 524–52 (Lawrence P. King ed., 15th ed. rev. 2005) (same); Jason J. Jardine, Note, *The Power of the Bankruptcy Court to Enjoin Creditor Claims Against Nondebtor Parties in Light of 11 U.S.C. § 524(e):* In re Dow Corning Corp., 2004 BYU L. REV. 283, 306–08 (2004) (same); *see also In re* Mahoney Hawkes, LLP, 289 B.R. 285, 299 (Bankr. D. Mass. 2002) (holding that because § 524(g) only applies in asbestos cases, it has no bearing on whether bankruptcy courts may issue non-debtor releases in other contexts).

Section 111(b), standing alone, casts serious doubt on the relevancy of § 524(g) to non-asbestos, third-party releases. But there are other problems with any reliance on § 524(g). First, § 524(h) sets forth rules regarding § 524(g)'s application to "existing injunctions." 11 U.S.C. § 524(h) (2000). This demonstrates Congressional acknowledgement and approval of injunctions issued before § 524(g) came into effect. Second, it is axiomatic that "the interpretation given by one Congress . . . to an earlier statute is of little assistance in discerning the meaning of that statute." Cent. Bank v. First Interstate Bank, 511 U.S. 164, 185 (1994); *accord* United States v. Clark, 445 U.S. 23, 33 n.9 (1980). Congress's understanding of § 524(e) when it enacted 524(g) thus has little, if any, interpretive value.

Accordingly, § 524(g) lends no support to the anti-release interpretation of § 524(e).

[205] 223 B.R. 1, 14 (N.D. Okla. 1998).

only be used to implement or enforce other Code provisions.[206] Quoting *Ahlers*, the court explained that the "[e]quitable powers conferred under Section 105 'must and can only be exercised within the confines of the Bankruptcy Code.'"[207] The statute is not a source of "substantive rights, such as a non-debtor discharge, otherwise unavailable under the Bankruptcy Code."[208] Thus, the court ruled, since no Code provision explicitly grants the power to extinguish non-debtor liabilities, § 105(a) may not be employed for that purpose.[209]

The clear implication of this reasoning, which has been adopted by several other courts,[210] is that § 105(a) does not permit the issuance of non-debtor releases unless the broad construction of that statute is correct.[211] Under the narrow reading, any exercise of § 105(a) power must be tethered to a specific provision in the Bankruptcy Code.[212] But, as one commentator explains, there is simply no Code "section that can serve as a pathway . . . to grant third-party" releases.[213]

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206 *Id.* For a discussion of the "narrow view" of § 105(a), see *supra* notes 125–36 and accompanying text.

207 *Id.* (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 207 (1988)).

208 *Id.* (citing United States v. Sutton, 786 F.2d 1305, 1307–08 (5th Cir. 1986)).

209 *Id.* at 4–5, 14 (ruling that the actual releases contained in the debtor's plan were invalid).

210 *See In re* Dow Corning Corp., 244 B.R. 721, 742 (Bankr. E.D. Mich. 1999) (holding that because § 105(a) must be used in conjunction with other Code provisions—i.e., it does not permit the creation of new substantive rights—the statute does not give bankruptcy courts the power to issue non-debtor releases) (citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988), and United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986)), *rev'd*, 255 B.R. 445, 480 (E.D. Mich. 2000), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648, 658 (6th Cir. 2002); *In re* Sybaris Clubs, Int'l, Inc., 189 B.R. 151, 155–56, 159 (Bankr. N.D. Ill. 1995) (holding that § 105(a) can only be used to carry out other provisions of the code—i.e., bankruptcy courts may not create new rights outside the Code—and thus that the non-debtor releases contained in the debtor's plan were invalid despite the fact that the sole objector would receive payment in full under the plan); *see also* Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 758, 762 (D. Utah. 1985) (holding that courts may use § 105(a) to grant non-debtor stays because they are "procedural," by which the court meant that they terminate upon confirmation of the plan of reorganization; further holding that courts may not employ § 105(a) to provide a non-debtor with "substantive" relief, by which the court meant relief that extends past confirmation); *In re* Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (holding that the court did not have sufficient power under § 105(a) to grant a non-debtor release, as part of a settlement between the debtor and its insurance company, that extinguished the contractual rights of a co-insured under the policy), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992).

211 *See* Meltzer, *supra* note 27, at 23–24 (concluding that since no Code provision expressly permits courts to issue non-debtor releases, § 105(a) may only be used to grant a release if the expansive view of the statute is adopted).

212 *Id.* at 18; *see also* Greenblatt v. Richard Potasky Jeweler, Inc. (*In re* Richard Potasky Jeweler, Inc.), 222 B.R. 816, 825 (S.D. Ohio 1998) ("Therefore, § 105, standing alone, cannot serve as a source of authority for granting a permanent injunction. Rather, § 105 must be *tethered* to another § of the Code in order to provide the court with such authority.") (emphasis added).

213 Meltzer, *supra* note 27, at 23; *accord* Boyle, *supra* note 27, at 438. Elaborating on this point, Meltzer argues that, in addition to the absence of any explicit authority for non-debtor releases, "there are no general or

Finally, even if the expansive interpretation of § 105(a)—or a similar reading of § 1123(b)(6)—is controlling, and courts thus possess substantial latitude in effectuating the Code's general policies,[214] one important argument remains that non-debtor releases are beyond the equitable authority of bankruptcy courts. That argument is presented in Part III.C.[215]

B. The Pro-Release Cases

1. MacArthur Co. v. Johns-Manville Corp.

Any discussion of pro-release case law must begin with *MacArthur Co. v. Johns-Manville Corp.*[216] While that case concerned the release of claims to

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specific licenses in the Code allowing judges to take such actions as they deem necessary to confirm plans of reorganization." Meltzer, *supra* note 27, at 23; *see also id.* at 18 ("[T]here is no mandate in the Code telling bankruptcy judges to do whatever is necessary to confirm plans, or giving them freewheeling authority to try to maximize the number of Chapter 11 cases that result in confirmed plans."). But § 1123(b)(6) arguably constitutes such a "general license." That statute provides that a plan of confirmation may "include any other appropriate provision not inconsistent with the applicable provisions of this title." 11 U.S.C. § 1123(b)(6) (2000). And two courts that have embraced the narrow view of § 105(a) ruled that the statute may be used in conjunction with § 1123(b)(6) to grant a third-party release. *See In re* Dow Corning Corp., 255 B.R. 445, 478 (E.D. Mich. 2000) ("The plain meaning of § 105(a) authorizes the bankruptcy court to enter only orders that are necessary to carry out the other provisions of the Code. . . . A third source of authority for a bankruptcy court to exercise [its § 105(a)] equitable power is found in 11 U.S.C. § 1123(b)(6) . . . ."), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648, 656–58 (6th Cir. 2002). However, as Boyle persuasively explains, such a use of these statutes constitutes "bootstrapping;" it amounts to employing "one catch-all provision to implement another catch-all provision," and that is inappropriate. Boyle, *supra* note 27, at 438.

The district court in the Dow Corning reorganization also held that a bankruptcy court may grant a non-debtor release by using § 105(a) to implement § 1141(a) (chapter 11 discharge provision) and § 1123(b)(3)(A) (stating that a plan may provide for "the settlement or adjustment of any claim or interest belonging to the debtor."). *Dow Corning Corp.*, 255 B.R. at 478. The district court was mistaken. First, as the express language of the statute makes clear, § 1123(b)(3)(A) governs resolution of the *debtor's* claims, not the direct claims of creditors. Accordingly, a release of the latter could not implement § 1123(b)(3)(A). Second, as carefully articulated by Professor Brubaker, a third-party release is not necessary to protect the debtor's discharge. *See* Brubaker, *supra* note 27, at 1002–09 (explaining that the Bankruptcy Code contains provisions that prevent claims against non-debtors from interfering with the debtor's discharge in the absence of a third-party release). Thus, such an order may not be understood as serving to enforce § 1141(a).

[214] For a discussion of the "broad view," see *supra* notes 137–46 and accompanying text.

[215] At least one court invalidated a non-debtor release on grounds independent of §§ 524(e) and 105(a). *See In re* Salem Suede, Inc., 219 B.R. 922, 927–28, 931–37 (Bankr. D. Mass. 1998) (holding that a non-debtor release unfairly discriminated under § 1129(b)(1) against the creditors affected by the release because other creditors did not need to give up rights against third parties to receive distributions under the plan); *see also In re* Dow Corning Corp., 244 B.R. 721, 740–42 (Bankr. E.D. Mich. 1999) (concluding that (1) § 524(e) does not prohibit non-debtor releases, (2) § 105(a) provides insufficient power to grant such releases, and (3) releases are not permissible under § 1123(b)(6) when applied to dissenting creditors because they employ an inappropriate legal fiction), *rev'd*, 255 B.R. 445, 480 (E.D. Mich. 2000), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648, 658 (6th Cir. 2002).

[216] 837 F.2d 89 (2d Cir. 1988).

insurance proceeds, it "pave[d] the way" for non-debtor releases beyond the insurance context.[217]

When Johns-Manville declared bankruptcy, it was facing tens of thousands of asbestos exposure claims and liability exceeding $2 billion.[218] During the company's reorganization, the bankruptcy court approved a settlement between the debtor and its insurers.[219] Under the agreement, the insurance companies paid Johns-Manville $770 million and were "relieved of all obligations related to the disputed policies."[220] To effectuate the settlement, the court "enjoined all suits against the insurers" concerning the policies.[221] It also ordered that any lawsuits subject to the injunction would attach only to the proceeds of the settlement.[222]

A distributor of Johns-Manville's products, MacArthur, claimed that it was a co-insured under the settled policies pursuant to a vendor endorsement that entitled the debtor's distributors "to insurance coverage resulting from their sale of Manville's products."[223] MacArthur argued on appeal that the injunction was an illegal discharge that improperly extinguished its rights under the insurance contract.[224] The Second Circuit disagreed.

The court explained that the injunction "did not offer the umbrella protection of a discharge in bankruptcy."[225] Instead, it precluded "only those suits against the settling insurers that arise out of or relate to Manville's insurance policies."[226] Moreover, MacArthur's claims were not extinguished; "they [were] simply channeled away from the insurers and redirected at the proceeds of the settlement."[227]

As authority for this type of injunction, the Second Circuit pointed to § 363(f).[228] That statute permits, in some circumstances, the sale of estate property "free and clear" of any third-party interest such as a lien.[229] The non-

217 Brubaker, *supra* note 27, at 962 n.3.
218 *Johns-Manville Corp.*, 837 F.2d at 90.
219 *Id.*
220 *Id.*
221 *Id.* at 91.
222 *Id.*
223 *Id.* at 90.
224 *Id.*
225 *Id.*
226 *Id.*
227 *Id.*
228 *Id.* at 93.
229 11 U.S.C. § 363(f) (2000).

debtor's rights are typically transferred to the proceeds of the sale.[230] The court reasoned that since Manville's policies belonged to the estate,[231] § 363(f) allowed the bankruptcy court to dispose of the insurance through the compromise and channel MacArthur's claims to the settlement payments.[232] The injunction expressly barring MacArthur and others from suing the insurance companies was "necessary to effectuate the Court's channeling authority. . . . The authority to issue the injunction is thus a corollary to the power to dispose of assets free and clear and to channel claims to the proceeds."[233]

The Second Circuit found additional authority for the injunction in § 105(a).[234] It observed that this statute "has been construed liberally to enjoin suits that might impede the reorganization process."[235] And the bankruptcy court found that direct actions against Johns-Manville's insurers "would adversely affect property of the estate and would interfere with reorganization."[236]

The Second Circuit admitted that the insurance settlement and the accompanying injunction "are not precisely the same as the traditional sale of real property free and clear of liens followed by a channeling of the liens to the proceeds of the sale."[237] The insurance polices were not actually sold and MacArthur's claim was distinct from a lien on property.[238] But "the

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230 3 COLLIER ON BANKRUPTCY ¶ 363.02[3] (Lawrence P. King ed., 15th ed. rev. 2005).

231 *Johns-Manville Corp.*, 837 F.2d at 93 (citing, *inter alia*, § 541(a)(1)). Section 541(a)(1) provides that a debtor's estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case," with only minor exceptions. § 541(a)(1).

232 *Johns-Manville Corp.*, 837 F.2d at 93.

233 *Id.*

234 *Id.*

235 *Id.*

236 *Id.*

237 *Id.* at 94. When a debtor actually sells an asset under § 363(f), the bankruptcy court may issue an injunction barring a creditor from attempting to enforce a preexisting lien on the property. Fogel v. Zell, 221 F.3d 955, 965 (7th Cir. 2000).

238 *Johns-Manville Corp.*, 837 F.2d at 94. In its discussion of the bankruptcy court's *jurisdiction* to issue the injunction, the Second Circuit stated that MacArthur did not have a direct claim under the policies; rather, its rights were "completely derivative of Manville's rights as the primary insured." *Id.* at 92. This language has caused some confusion regarding whether MacArthur's claims were derivative, and thus property of the estate, or direct, and thus rights belonging entirely to MacArthur. *Compare In re* Elsinore Shore Assoc., 91 B.R. 238, 253 (Bankr. D.N.J. 1988) (holding that *Johns-Manville* could not be extended to apply to the non-debtor releases of direct creditor claims contained in Elsinore's plan because the release in *Johns-Manville* was of claims that were property of the estate), *with In re* Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (arguing that MacArthur's claims in *Johns-Manville* were not derivative), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992). I side with the court in *Forty-Eight Insulations*. I do not think the Second Circuit was using

underlying principle of preserving the debtor's estate for the creditors and funneling claims to one proceeding in the bankruptcy court remains the same."[239] Since the settlement was "essential . . . to a workable reorganization, it falls well within the bankruptcy court's equitable powers."[240]

2. In re A.H. Robins Co.

The Fourth Circuit extended *Johns-Manville*'s holding to third-party releases of direct claims against non-debtors in *In re A.H. Robins Co.*,[241] the seminal pro-release decision.[242] Like Johns-Manville, A.H. Robins was driven into bankruptcy by a mass tort—product liability claims surrounding the Dalkon Shield, its notorious contraceptive device.[243] Indeed, there were over 195,000 Dalkon Shield claimants in the bankruptcy.[244]

The plan of reorganization in *A.H. Robins* contained a non-debtor release that permanently enjoined the Dalkon Shield claimants from suing any party

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the term "derivative" in its technical legal sense. That is why I classified *Johns-Manville* as an "insurance" case rather than a "derivative" case in the taxonomy section above. *See supra* note 67 and accompanying text. If MacArthur's claims were merely property of the Johns-Manville estate, citation to § 363(f) would have been unnecessary. The court could have relied upon § 1123(b)(3)(A). 11 U.S.C. § 1123(b)(3)(A) (2000) ("[A] plan may . . . provide for . . . the settlement or adjustment of any claim or interest *belonging to the debtor or to the estate* . . . .") (emphasis added). Nonetheless, whether MacArthur's claim was derivative—i.e., property of the estate—or merely a claim *against* property of the estate, it was certainly *not* a *direct* claim against *non-estate* property or an independent third party, the type of claim extinguished by the non-debtor releases that are the focus of this Article.

239 *Johns-Manville Corp.*, 837 F.2d at 94.

240 *Id.*; *see also In re* Dow Corning Corp., 198 B.R. 214, 245 (Bankr. E.D. Mich. 1996) (holding, for purposes of § 363(f), that "[e]quating compromises/settlements of lawsuits to sales of a debtor's property is appropriate because there is so little to distinguish them"); *id.* at 244–47 (further holding that the debtor's settlement with its liability insurers could be conducted free and clear of any rights in the insurance policies held by parties harmed by the debtor's products and that, under §§ 105(a) and 363(f), the court could enjoin the injured parties from suing the insurers). *But see In re* Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (holding that the court did not have sufficient power under § 105(a) to grant a non-debtor release, as part of a settlement between the debtor and its insurance company, that extinguished the contractual rights of a co-insured under the policy because, *inter alia*, the co-insured's rights were not part of the debtor's estate), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992).

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

242 *See* Brubaker, *supra* note 27, at 1024 (observing that *Robins* is "the watershed case paving the way for growing judicial acceptance of non-debtor releases").

243 *In re* A.H. Robins Co., 88 B.R. 742, 743–44 (E.D. Va. 1988), *aff'd*, 880 F.2d 694 (4th Cir. 1989); *see generally* RONALD J. BACIGAL, LIMITS OF LITIGATION: THE DALKON SHIELD CONTROVERSY (1990); MARY F. HAWKINS, UNSHIELDED: THE HUMAN COST OF THE DALKON SHIELD (1997); MORTON MINTZ, AT ANY COST: CORPORATE GREED, WOMEN, AND THE DALKON SHIELD (1985); SUSAN PERRY AND JIM DAWSON, NIGHTMARE: WOMEN AND THE DALKON SHIELD (1985); RICHARD B. SOBOL, BENDING THE LAW: THE STORY OF THE DALKON SHIELD BANKRUPTCY (1993).

244 *A.H. Robins Co.*, 88 B.R. at 747.

for their injuries.[245] A.H. Robins's directors and attorneys, Aetna (the debtor's insurer), and Aetna's attorneys were among those that benefited from the release.[246] The plan also created several claims resolution trusts intended to provide compensation to the injured women.[247] The district court found that the tort creditors would be able to recover in full for their injuries from the trusts,[248] which were funded by, inter alia, the debtor, members of the Robins family and Aetna.[249]

Because most of the Dalkon Shield claims were unliquidated,[250] the district court conducted an "estimation" hearing to determine how much money was needed to fully compensate the tort claimants.[251] The court ultimately found "that the sum of $2.475 billion . . . is sufficient to pay in full all Dalkon Shield personal injury claims as well as expenses of the Trusts established to administer the claims."[252] The plan provided that this amount would be placed in the trusts.[253]

Dalkon Shield claimants that filed their claims on time (class A) were allowed to liquidate their rights via a jury trial.[254] Those that did not file by the deadline (class B) could not litigate their claims before a jury.[255] However, members of class B were given a limited right to opt out of the plan and the non-debtor release. By exercising this opportunity, they could sue Aetna and their medical providers in tort, but they waived their right to compensation

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245 *In re* A.H. Robins Co., 131 B.R. 292, 294–96 (E.D. Va. 1991), *rev'd and remanded sub nom.* Dalkon Shield Claimants Trust v. Reiser (*In re* A.H. Robins Co.), 972 F.2d 77 (4th Cir. 1992).

246 Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 700–01 (4th Cir. 1989). Despite the inclusion of Aetna in the release, *Robins* is not an insurance-release case. The women sought to pursue Aetna directly in tort, not as joint-claimants under A.H. Robins's insurance polices. *Id.* ("The suits in question which some of the appellants wish to bring are against Robins's directors, Robins's and Aetna's attorneys, and Aetna, seeking to hold them as joint tortfeasors with Robins for Dalkon Shield injuries.").

247 *A.H. Robins Co.*, 88 B.R. at 750–51.

248 *Id.* at 751. The district court withdrew the reference and presided over A.H. Robins's bankruptcy with the assistance of the bankruptcy judge. *Id.* at 743.

249 *Menard-Sanford*, 880 F.2d at 700–02; *A.H. Robins Co.*, 88 B.R. at 751.

250 *Menard-Sanford*, 880 F.2d at 697.

251 *Id.* at 697–700; *see also* 11 U.S.C. § 502(c) (2000) ("There shall be estimated for purposes of allowance . . . any contingent or unliquidated claim, the fixing or liquidation of which, as they case may be, would unduly delay the administration of the case . . . .").

252 *A.H. Robins Co.*, 88 B.R. at 747.

253 *In re* A.H. Robins Co., 880 F.2d 709, 720–21 (4th Cir. 1989).

254 Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 700 (4th Cir. 1989).

255 *Id.*

from the trusts under the plan.[256] Moreover, the opt-outs could not sue anyone other than Aetna and their medical providers.[257]

The vast majority of Dalkon Shield claimants voting (131,761 of 139,605) did so in favor of confirmation.[258] After the plan was confirmed by the district court, several objectors appealed to the Fourth Circuit, challenging the propriety of the non-debtor release.[259]

The Fourth Circuit held that the district court possessed sufficient equitable power under § 105(a) to grant the release.[260] It offered two reasons. First, the court of appeals explained that the release was essential to the reorganization.[261] Any lawsuits by Dalkon Shield claimants against the released parties "would affect the bankruptcy reorganization in one way or another such as by way of indemnity or contribution,"[262] and "the entire 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."[263] Second, the court found that the plan provided the Dalkon Shield claimants with payment in full,[264] affirming the district court's estimation of the value of their claims.[265] The Fourth Circuit reached this conclusion even though the funding for the claims resolution trust was capped by the plan at $2.475 billion, and thus, if the estimation were inaccurate, there might not be enough money to pay all injured women in full.[266]

The *Robins* court found additional support for the non-debtor release in "the ancient but very much alive doctrine of marshalling of assets."[267] Pursuant to that doctrine, a "creditor has no right to choose which of two funds will pay his claim."[268] A bankruptcy court may "order a creditor who has two funds to satisfy his debt to resort to the fund that will not defeat other

256 *Id.* at 701.
257 *Id.*
258 *Id.* at 698.
259 *Id.* at 696.
260 *Id.* at 701.
261 *Id.* at 701–02.
262 *Id.*
263 *Id.* at 702. If a creditor successfully recovers from a co-obligor of the debtor, the co-obligor may in turn have a contribution or indemnity claim against the debtor. Brubaker, *supra* note 27, at 973–74.
264 *Menard-Sanford*, 880 F.2d at 700–02.
265 *Id.* at 700.
266 *Id.* at 697. Because it contained a non-debtor release, the plan placed the risk that there would be insufficient funds on the Dalkon Shield claimants rather than on the released third parties.
267 *Id.* at 701. *See supra* notes 112–14 and accompanying text (discussing marshaling of assets).
268 *Menard-Sanford*, 880 F.2d at 701.

creditors."[269] The Fourth Circuit's point appeared to be that if a bankruptcy court may force a creditor to recover from a particular source, then the Dalkon Shield claimants could be compelled to recover solely from A.H. Robins.

The court admitted that class B opt-outs were not entitled to recover under the plan.[270] But, the Fourth Circuit responded, "Since they have chosen opt-out rather than payment in full, they may have no complaint about a restriction placed on their ability to sue others[,]" particularly since the bankruptcy courts' equitable powers may be invoked "'to the end that . . . substance will not give way to form, that technical considerations will not prevent substantial justice.'"[271]

At last, the Fourth Circuit addressed § 524(e). While it acknowledged the Ninth Circuit's holding in *Underhill*, the court of appeals was persuaded by language from a Fifth Circuit opinion explaining that § 524(e) "'does not by its specific words preclude the discharge of a guaranty when it has been accepted and confirmed as an integral part of reorganization.'"[272] Thus, the Fourth Circuit continued, "Whatever the result might be as to the application of § 524(e) in other cases, we do not think that section must be literally applied in every case as a prohibition on the power of the bankruptcy courts."[273] The court concluded that § 524(e) did not bar the non-debtor release in A.H. Robins's plan because the release was essential to the reorganization, the creditors overwhelmingly approved the plan, the plan provided the Dalkon Shield claimants with the opportunity to receive payment in full, and Aetna contributed to the Plan.[274]

3. Robins*'s Progeny and the Power to Grant Non-Debtor Releases*

A substantial number of cases have followed *Robins* and ruled that non-debtor releases are permissible under the Bankruptcy Code. Most of these decisions found that the authority to extinguish claims against third parties emanates from § 105(a). Implicitly adopting the broad view of that provision,

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269 *Id.*

270 *Id.* at 702.

271 *Id.* (internal quotation marks omitted) (quoting MacArthur v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 94 (2d Cir. 1988)).

272 *Id.* (quoting Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1050 (5th Cir. 1987)). *Shoaf* did not ultimately address whether § 524(e) bars non-debtor releases because it found that res judicata prohibited any claim to that effect. *Shoaf*, 815 F.2d at 1050–54.

273 *Menard-Sanford*, 880 F.2d at 702.

274 *Id.*

the courts decided that § 105(a), standing alone, grants sufficient power to issue non-debtor releases.[275] And at least one court has suggested that both

[275] For the decisions in the First Circuit, see Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 985 (1st Cir. 1995) (the bankruptcy court, whose opinion is attached as an appendix to the First Circuit decision, held that § 105(a) provides sufficient authority to issue non-debtor releases); Monarch Life Ins. Co. v. Ropes & Gray (*In re* Monarch Capital Corp.), 173 B.R. 31, 42 (D. Mass. 1994) (courts may grant non-debtor releases pursuant to § 105(a)), *aff'd*, 65 F.3d 973 (1st Cir. 1995); *In re* Mahoney Hawkes, LLP, 289 B.R. 285, 300 (Bankr. D. Mass. 2002) (holding that bankruptcy courts may grant non-debtor releases under § 105(a)).

For decisions in the Second Circuit, see SEC v. Drexel Burnham Lambert Group, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 960 F.2d 285, 293 (2d Cir. 1992) (citing *Robins* for the proposition that bankruptcy courts may enjoin litigation against a non-debtor); Greer v. Gaston & Snow (*In re* Gaston & Snow), Nos. 93 Civ. 8517 (JGK), 93 Civ. 8628 (JGK), 1996 WL 694421, at *2-*5 (S.D.N.Y. Dec. 4, 1996) (holding that § 105(a) grants bankruptcy courts substantial authority over creditor-debtor relationships and citing *Drexel* for the proposition that non-debtor releases are permissible); Abel v. Shugrue (*In re* Ionosphere Clubs, Inc.), 184 B.R. 648, 655 (S.D.N.Y. 1995) (citing *Drexel* and *Robins* for the proposition that bankruptcy courts may grant non-debtor releases); LTV Corp. v. Aetna Cas. & Sur. Co. (*In re* Chateaugay Corp.), 167 B.R. 776, 780 (S.D.N.Y. 1994) (holding that bankruptcy courts may issue non-debtor releases under § 105(a)); Myerson & Kuhn v. Brunswick Assoc. Ltd. P'ship (*In re* Myerson & Kuhn), 121 B.R. 145, 150, 154–57 (S.D.N.Y. 1990) ("Section 105 grants bankruptcy courts ample power to enjoin actions excepted from the automatic stay which might interfere in the rehabilitative process, whether in a liquidation or in a reorganization case.") (internal quotation marks omitted) (suggesting that the debtor's plan could include a non-debtor release). *But see* Deutsche Bank AG v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 142 (2d Cir. 2005) (endorsing the narrow view of § 105(a) during its discussion of a third-party release by stating that "[a]ny power that a judge enjoys under § 105 must derive ultimately from some other provision of the Bankruptcy Code") (internal quotation marks omitted). The *Deutsche Bank* court never explained, however, where the power to grant a non-debtor release actually comes from if § 105(a), by itself, is not sufficient.

For the decisions in the Third Circuit, see *In re* Am. Family Enters., 256 B.R. 377, 408 (D.N.J. 2000) (holding that § 105(a) permitted the court to grant non-debtor releases); Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 305 (Bankr. E.D. Pa. 1999) ("Section 105(a) of the Bankruptcy Code grants the Court broad equitable power[s] . . . .") (holding that non-debtor releases are permissible under § 105(a)).

For the decision in the Eighth Circuit, see *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 934–37 (Bankr. W.D. Mo. 1994) (concluding that bankruptcy courts may issue non-debtor releases pursuant to § 105(a)).

For the decisions in the Eleventh Circuit, see *In re* Transit Group, Inc., 286 B.R. 811, 815–18 (Bankr. M.D. Fla. 2002) (observing that § 105(a) confers "broad equitable authority" on bankruptcy courts and holding that the statute grants such courts the power to issue non-debtor releases); *In re* Optical Tech., Inc., 216 B.R. 989, 994 (Bankr. M.D. Fla. 1997) ("Section 105 . . . is broadly written and allows all orders necessary to effectuate a reorganization, including permanently enjoining actions of third parties which . . . would interfere with reorganization.") (internal quotation marks omitted).

For the decisions in the District of Columbia Circuit, see *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 685 (Bankr. D.D.C. 1992) ("Under section 105(a) a bankruptcy court may enter a permanent injunction enjoining suits against non-debtor parties funding a plan of reorganization if the court finds that such an injunction is essential to effectuate the plan of reorganization."); *In re* McCall, No. 93-00632, 1997 WL 428580, at *16 (Bankr. D.D.C. May 27, 1997) (same).

The analysis offered on this point in each of the cases cited in this footnote was extremely perfunctory, generally consisting of one or two sentences. *See also* Buschman, *supra* note 27, at 942–43 (concluding that

§§ 105(a) and 1123(b)(6) allow bankruptcy courts to release non-debtor claims.[276]

As for § 524(e), *Robins*'s progeny have endorsed a different view of that statute. The Fourth Circuit intimated that § 524(e) generally bars non-debtor releases, but that this prohibition may be overcome in rare circumstances, such as those present in the A.H. Robins reorganization.[277] Most other pro-release courts, in contrast, have found that § 524(e) is irrelevant to the validity of non-debtor releases. They reason as follows.

Section 524(e) does not expressly prohibit releases; it merely provides that the discharge of a debtor does not, "by itself, affect the liability of other parties."[278] Thus, when a plan of reorganization contains no explicit third-

§ 105(a) grants bankruptcy courts sufficient power to issue non-debtor releases); Han, *supra* note 27, at 554, 579 (same); Inman, *supra* note 27, at 649 (same); Jardine, *supra* note 204, at 309–10 (same).

[276] *In re* Trans World Airlines, Inc., 185 B.R. 302, 313, 321–22 (Bankr. E.D. Mo. 1995) (indicating that bankruptcy courts may issue non-debtor releases pursuant to §§ 105(a) and 1123(b)(6)); *see also* Feldstein, *supra* note 27, at 39–40, 45 (appearing to conclude that the power to issue non-debtor releases exists under §§ 105(a) and 1123(b)(6), but referring primarily to the release of *derivative* claims); Swallow, *supra* note 27, at 723, 726 (arguing that non-debtor releases are permissible under § 1123(b)(6) (located at § 1123(b)(5) when the Article was written)); *cf. In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673757, at *9 (Bankr. M.D.N.C. Feb. 24, 2000) (concluding that §§ 105(a) and 1123(b)(6) confer upon bankruptcy courts sufficient authority to issue provisional injunctions).

At least two cases have held that non-debtor releases are permissible even if the narrow view of § 105(a) is correct. For a discussion of why these decisions are mistaken, see *supra* note 213.

[277] *Menard-Sanford*, 880 F.2d at 702; *see also In re* Boston Harbor Marina Co., 157 B.R. 726, 730 (Bankr. D. Mass. 1993) (holding that § 524(e) barred the non-debtor release in the debtor's plan, but noting, in dicta, that the statute may not apply in certain circumstances, including mass tort cases where the third-party's creditors are paid in full on their claims); Buschman, *supra* note 27, at 942, 946 (arguing that non-debtor releases are prohibited by § 524(e) unless they are (1) necessary to the debtor's reorganization, and (2) the third party contributes to the estate an amount that reflects its net worth or potential liability); Swallow, *supra* note 27, at 709 (concluding that § 524(e) bars non-debtor releases unless there is (1) payment in full on the released claims, (2) the release is necessary, and (3) an overwhelming majority of creditors support the plan); Lewis, *supra* note 27, at 176 (maintaining that non-debtor releases run afoul of § 524(e) unless the extinguished claims are paid in full).

[278] *In re* Transit Group, Inc., 286 B.R. 811, 816 (Bankr. M.D. Fla. 2002); *accord* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 657 (6th Cir. 2002) ("[Section 524(e)] explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor."); Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 985 (1st Cir. 1995) (the bankruptcy court, whose confirmation opinion is attached as an appendix to the First Circuit decision, held that "section 524(e) . . . does not by its terms preclude the entry of injunctive relief in favor of nondebtors making plan contributions, particularly where as here, creditors have overwhelmingly consented to it"); *In re* Dow Corning Corp., 255 B.R. 445, 477–78 (E.D. Mich. 2000) ("On its face, § 524(e) does not set forth a per se rule prohibiting permanent injunctions as to non-debtors. . . . [The statute] does not expressly prohibit third-party injunctions . . . ."), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648 (6th Cir. 2002); *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 936 (W.D. Mo. 1994) ("To the extent that § 524(e) does not explicitly prohibit the court from issuing a permanent injunction, the language is clear . . ."); LTV Corp. v. Aetna Cas. & Sur. Co. (*In re* Chateaugay

party release, § 524(e) ensures that non-debtor liabilities are unchanged.[279] But that is the limit of the statute's impact.[280] Reading § 524(e) to also prohibit non-debtor releases contravenes the Supreme Court's admonishment that statutes should be given a plain-meaning construction and creates a conflict

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Corp.), 167 B.R. 776, 780 (S.D.N.Y. 1994) ("§ 524(e) does not address whether a bankruptcy court can expressly discharge or otherwise affect the liability of a non-debtor. This section provides . . . [that] a bankruptcy court's discharge of a debtor does not by itself relieve a co-debtor or non-debtor of liability."); Monarch Life Ins. Co. v. Ropes & Gray (*In re* Monarch Capital Corp.), 173 B.R. 31, 43 (D. Mass. 1994) ("Section 524(e) contains no language of prohibition and should not be interpreted to limit the court's power under § 105(a).") (internal quotation marks omitted), *aff'd*, 65 F.3d 973 (1st Cir. 1995); *In re* Mahoney Hawkes, LLP, 289 B.R. 285, 299 (Bankr. D. Mass. 2002) ("11 U.S.C. § 524(e) does not specifically prohibit the [permanent] injunctions which the Debtor is seeking in this case. That section only describes the parameters of a discharge order."); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 687 (Bankr. D.D.C. 1992) ("[Section 524(e)] is merely declarative of the effect of a discharge under § 524. It does not affect the ability of the court to issue a permanent injunction under § 105(a) that affects the liability of a non-debtor on the debtor's debts. . . . Section 524(e) contains no language of prohibition and should not be interpreted to limit the court's power under § 105(a)."); *see also* Feldstein, *supra* note 27, at 29 ("[S]ection 524(e) simply describes the effect of a naked discharge under section 524(a) and imposes no restriction upon the terms of a plan of reorganization. . . . Section 524(e), by its terms, is not a limitation upon the validity of third-party releases pursuant to a plan of reorganization that otherwise satisfies the standards for confirmation under sections 1129 and 1141."); Inman, *supra* note 27, at 649 ("Section 524(e) merely provides that the discharge of the debtor's debts under a reorganization does not, by itself, discharge the liabilities of any other parties."); Jardine, *supra* note 204, at 306 ("The Sixth Circuit correctly recognized that nothing in the language of § 524(e) prohibits the release of a nondebtor."); Swallow, *supra* note 27, at 711 ("[A] careful reading of [§ 524(e)] reveals only that a *discharge of the debtor* has no *automatic* effect on third parties. In other words, section 524(e) does not expressly prohibit a court . . . from limiting the liability of a third-party debtor.").

A number of anti-release authorities agree with this more narrow construction of § 524(e). *See, e.g.*, *In re* Digital Impact, Inc., 223 B.R. 1, 10 (N.D. Okla. 1998) ("This Court does not believe that Section 524(e) was intended to *prohibit* [non-debtor] releases. Rather, Section 524(e) was intended to insure that co-debtors or guarantors (who are not debtors in the bankruptcy case), and their property, are not *automatically* released from the debt or guaranty upon the discharge of a debtor, and that rights of creditors are not impaired by the debtor's discharge."); *In re* Dow Corning Corp., 244 B.R. 721, 740 (Bankr. E.D. Mich. 1999) ("[Section 524(e)] simply provides in effect that a third party's liability is not discharged by virtue of a discharge of the debtor's liability. It does not by its terms preclude a court from discharging the liability of a third party. The better view, then, is that entry of a non-debtor [release] . . . is not incompatible with § 524(e)."), *rev'd on other grounds*, 255 B.R. 445 (E.D. Mich. 2000), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648 (6th Cir. 2002); Brubaker, *supra* note 27, at 972 ("[T]he literal terms of section 524(e) say only that the debtor's discharge does not, by its own force, affect the liability of others. Nothing in section 524(e) can be read to affirmatively prohibit a bankruptcy court from using its equitable injunctive powers in furtherance of a successful reorganization . . . ."); *see also In re* Specialty Equip. Cos., 3 F.3d 1043, 1046–47 (7th Cir. 1993) ("[S]ection 524(e) provides only that a discharge does not affect the liability of third parties. This language does not purport to limit or restrain the power of the bankruptcy court to otherwise grant a release to a third party.") (holding that § 524(e) did not bar the consensual non-debtor release at issue and noting that there was no need to address whether § 524(e) prohibits involuntary releases).

279 *In re* Transit Group, Inc., 286 B.R. 811, 816 (Bankr. M.D. Fla. 2002) ("Section 524(e) does not overtly bar a plan from providing non-debtor releases, but simply provides that, if the plan does not otherwise specify such releases, the discharge arising under section 1141 does not affect a creditor's claim against a non-debtor."). For additional authorities supporting this understanding of § 524(e), see *supra* notes 153 & 156.

280 *See* authorities cited *supra* note 278.

with § 105(a) and the bankruptcy court's broad equitable powers where there need not be one.[281] Finally, since § 524(e)'s language is clear, there is no reason to consider its antecedents in the Bankruptcy Act, as some anti-release courts did in analyzing the statute.[282] Section 524(e) thus does not bar third-party releases.[283]

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[281] *In re* Dow Corning Corp., 255 B.R. 445, 478 (E.D. Mich. 2000) ("When the plain meaning of a statute is clear, the court's inquiry is at an end. . . . A court should interpret the Code in a manner that avoids a conflict between its various sections.") (citations omitted), *rev'd on other grounds*, 280 F.3d 648 (6th Cir. 2002); *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 936 (W.D. Mo. 1994) ("First, the clear pattern that has emerged from recent Supreme Court rulings is that an analysis of the plain meaning of the statute is to be used in construing the Bankruptcy Code. . . . To interpret [§ 524(e)] as prohibiting all permanent injunctions would create a conflict with § 105 where there need be none."); *In re* Optical Tech., Inc., 216 B.R. 989, 994 (Bankr. M.D. Fla. 1997) (adopting a narrow construction of § 524(e) under which the statute does not prohibit non-debtor releases because that interpretation is consistent with § 105(a)'s broad grant of equitable power); Swallow, *supra* note 27, at 721 (arguing that because the Supreme Court has ruled that the plain meaning of a statute is conclusive in construing the statute, "it is evident" that § 524(e) does not prohibit non-debtor releases).

[282] *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 936 (W.D. Mo. 1994) (concluding that because the Supreme Court requires a plain-meaning approach to interpretation of the Bankruptcy Code, the Ninth and Tenth Circuits should not have looked at the statute's predecessors in construing it); Swallow, *supra* note 27, at 721 (given the Supreme Court's precedents on statutory construction, "If section 524(e) does not provide an express basis for denying confirmation of the injunction, and no other express provision is contained in the Code, there is no ground for precluding" a third-party release).

[283] Some pro-release authorities have suggested that channeling releases do not violate § 524(e) because, in their view, the release does not actually "impair" or "discharge" the creditor's claims. *See, e.g.*, *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 687 (Bankr. D.D.C. 1992) (concluding that because the partners shielded by the non-debtor release were obligated to provide "the entire funding of the debtor's plan" (instead of paying creditors directly), the partners were "not receiving a discharge of their obligations to creditors; they are merely exchanging one obligation for another"); Lewis, *supra* note 27, at 176 (concluding that non-debtor releases do not violate § 524(e) when the extinguished claims are paid in full because such claims are not "impaired" by the release); Inman, *supra* note 27, at 649–50 (arguing that third parties "are not truly released from liability" by non-debtor releases when the third parties contribute money to the estate that provides "a mechanism for payment of creditor claims. . . . To suggest that . . . creditor claims were prejudiced in [the pro-release cases affirming channeling releases] is incorrect."). A number of anti-release courts implied the same point when they distinguished opinions approving of channeling releases. *See infra* note 392 and accompanying text. Thus, it could be asserted that even if § 524(e) generally bars third-party releases, the prohibition is inoperative where the "extinguished" claims are paid in full.

This argument is unpersuasive. Section 524(e) provides that the discharge of the debtor may not "*affect* the liability of any other entity." 11 U.S.C. § 524(e) (2000) (emphasis added). But a non-debtor release clearly "affects" the liability of the benefiting party. The release *eliminates* the non-debtor's obligation to the creditor. It does so even if the third party has not contributed any assets to the plan of reorganization. Moreover, the creditor is losing an alternative source of recovery. *See In re* Digital Impact, Inc., 223 B.R. 1, 9 (N.D. Okla. 1998) (observing that channeling releases limit the sources of compensation available to the creditor). If the debtor is unable to comply with the terms of its plan, the creditor may not pursue the non-debtor to recover any deficiency. Critically, plan failures of this type are not uncommon. *See infra* notes 367–69 and accompanying text (explaining that a large percentage of debtors default on their plan obligations).

In essence, a non-debtor release "forcibly converts creditors' in personam claims against a non-debtor into [more narrow] in rem claims against the debtor's property." Brubaker, *supra* note 27, at 1038. There is

4. *Circumstances in Which Pro-Release Courts Will Grant a Non-Debtor Release*

While pro-release courts generally agree upon the source of their authority to issue non-debtor releases, they differ in critical respects over the circumstances in which such authority may be exercised. In *Robins*, the Fourth Circuit approved of the non-debtor release for several reasons: (1) the release was essential to A.H. Robins's plan because the reorganization hinged upon the debtor being free from indemnity and contribution lawsuits that third parties would have brought had they been sued by the Dalkon Shield claimants; (2) the creditors voted overwhelmingly in favor of the plan; (3) the plan provided the Dalkon Shield claimants with the opportunity to receive payment in full on the released claims; and (4) Aetna contributed substantial assets to the Plan.[284] These elements have since evolved into a five-factor test that a majority of pro-release courts use in assessing whether to grant a non-debtor release.

Reviewing *Johns-Manville*, *Robins* and some of their early progeny, the bankruptcy court in *In re Master Mortgage Investment Fund, Inc.* set forth what is now the most authoritative formulation of the test.[285] First, there must be "an identity of interest 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 assets of the estate."[286] To elaborate, a

no doubt that this constitutes an "affect" on the non-debtor's liability. Indeed, a number of courts have found that provisional injunctions, which do not even purport to extinguish claims, improperly "affect" a third-party's liability and thus violate § 524(e). *See In re* Davis Broad., Inc., 176 B.R. 290, 291–92 (M.D. Ga. 1994) (§ 524(e) bars a bankruptcy court from "affecting" the liability of a guarantor in any way, including through a provisional injunction staying creditors' legal actions against certain third parties pending execution of the plan) ("It is thus clear that this is a post-confirmation injunction and violates 11 U.S.C. Section 524(e) and accordingly exceeds the power and authority of the Bankruptcy Court because the section referred to prohibits release or a post-confirmation stay of the obligations of non-party guarantors. . . . Of course, the liability of a guarantor is 'affected' regardless of whether it is released or, as in this case, stayed for a long period of time."); Seaport Automotive Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts, Inc.), 113 B.R. 610, 614–16 (B.A.P. 9th Cir. 1990) (holding that § 524(e) prohibited a provisional injunction that stayed collection efforts against certain non-debtors for five years after confirmation of the plan); *see also* Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 758, 762 (D. Utah 1985) (holding that postconfirmation injunctions staying legal action against a non-debtor are impermissible; invalidating a chapter 11 plan provision that appears to be a provisional injunction). Accordingly, if § 524(e) prohibits non-debtor releases, it bars *all* such releases—both actual releases and channeling releases.

[284] Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 701–02 (4th Cir. 1988).

[285] *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930 (Bankr. W.D. Mo. 1994).

[286] *Id.* at 935 & n.4 (collecting authorities); *see also* Inman, *supra* note 27, at 641 ("Generally courts look for some sort of indemnity relationship between the debtor and third party such that any suit against the third party may deplete the assets of the debtor estate.").

creditor's action against a co-obligor generally provides the co-obligor with a contribution or indemnity claim against the debtor.[287] The assertion of such a claim can drain property from the estate. Thus, the co-obligor and the debtor have an "identity of interest" because a suit against the co-obligor can impact the debtor indirectly.[288]

Second, the third party must contribute "substantial" assets to the reorganization.[289] This typically entails giving large sums of money to the estate for distribution to creditors and/or the release of claims the non-debtor possesses against the debtor.[290]

Third, the release must be "essential to the reorganization. Without the release, there is little likelihood of success."[291] To illustrate, in the absence of a release, non-debtors may refuse to contribute assets to the estate that are "necessary" for the debtor's reorganization. Without the payments, the debtor will be forced to liquidate, which means that creditors will likely recover much less, if they recover at all, and the debtor will not be able to resume its business.[292]

Fourth, a "substantial majority of the creditors agree to [the release], specifically, the impacted class, or classes has 'overwhelmingly' voted to accept the proposed plan treatment."[293] In *Master Mortgage*, for example,

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[287] *See* Brubaker, *supra* note 27, at 973–74.

[288] *See, e.g.*, *In re* Am. Family Enters., 256 B.R. 377, 391–92 (D.N.J. 2000) (approving of a non-debtor release because, among other reasons, the debtor had indemnified the releasees and lawsuits against them would have lead to the assertion of indemnity claims against the debtor, which ultimately would have depleted assets of the estate); *Master Mortgage*, 168 B.R. at 937 (holding that the existence of an indemnity relationship between the debtor and the released non-debtor satisfied the first element of the test).

[289] *Master Mortgage*, 168 B.R. at 935 & n.5 (collecting authorities).

[290] *Id.* at 937–38 (non-debtors' contributions included the release of claims against, or the assignment of interests to, the debtor); *Am. Family Enters.*, 256 B.R. at 392 (released third parties contributed over $70 million to the estate for distribution through the reorganization plan).

[291] *Master Mortgage*, 168 B.R. at 935 & n.6 (collecting authorities).

[292] *Id.* at 938 (without a release, the non-debtors would not have made contributions that enabled the debtor to formulate a workable plan and allowed creditors to recover in full); *Am. Family Enters.*, 256 B.R. at 391–92 (contributions of third parties that made possible (1) significant distributions to creditors, and (2) the continued operation of the debtors, were contingent upon the third parties obtaining releases); *see also* Cartalemi v. Karta Corp. (*In re* Karta Corp.), 342 B.R. 45, 54–57 (S.D.N.Y. 2006) (approving of a non-debtor release because, *inter alia*, the reorganization plan was made possible by the principals' substantial financial contributions and the principals refused to make the contributions without a release).

[293] *Master Mortgage*, 168 B.R. at 935 & n.7 (collecting authorities).

94.8% and 93.4% of the two classes affected by the release voted for the plan.[294]

Fifth, the plan provides for "payment of all, or substantially all, of the claims of the class or classes affected by the" non-debtor release.[295] In *Master Mortgage*, all of the extinguished non-debtor claims were to be paid in full under the plan.[296] However, smaller distributions have been held to satisfy this element.[297]

A number of courts have adopted the *Master Mortgage* test.[298] And a

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294 *Id.* at 938; *see also Am. Family Enters.*, 256 B.R. at 392 (100% of two impacted classes and 99.99% of the third voted for the plan).

295 *Master Mortgage*, 168 B.R. at 935 & n.8 (collecting authorities). While the *Master Mortgage* court stated that these factors "do not appear to be an exclusive list of considerations," *id.* at 935, they have largely become so.

296 *Id.* at 938.

297 *See, e.g.*, *Am. Family Enters.*, 256 B.R. at 392 (holding that a 90% distribution to one class and 100% distributions to two other classes impacted by the release met the fifth element of the *Master Mortgage* test).

298 For decisions adopting the test in the First Circuit, see *In re* M.J.H. Leasing, Inc., 328 B.R. 363, 369–72 (Bankr. D. Mass. 2005) (applying the test but concluding that the channeling release proposed in the debtor's disclosure statement was improper because it failed to satisfy most of the *Master Mortgage* factors); *In re* Mahoney Hawkes, LLP, 289 B.R. 285, 300–03 (Bankr. D. Mass. 2002) (adopting the test but finding invalid both of the proposed non-debtor releases—an insurance company release and an actual release of partners in the debtor, which was a limited liability partnership).

For a decision adopting the test in the Third Circuit, see *Am. Family Enters.*, 256 B.R. at 386–87, 390–92, 405–08 (following *Robins* and *Master Mortgage* and approving of several non-debtor releases because the five factors were satisfied; notably, the plan did not provide for payment in full—the tort claimants subject to the release only received *ninety percent* of their claims).

For a decision adopting the test in the Sixth Circuit, see *In re* Dow Corning Corp., 255 B.R. 445, 479–81 (E.D. Mich. 2000) (adopting the test and approving of the channeling releases in the debtor's plan because all five factors were met), *rev'd in part*, 280 F.3d 648, 658 (6th Cir. 2002) (endorsing the *Master Mortgage* test, but adding a sixth factor—that "the plan provides an opportunity for those claimants who choose not to settle to recover in full").

For decisions adopting the test in the Eighth Circuit, see *Master Mortgage*, 168 B.R. at 935, 937–38 (adopting the test and approving of a channeling release in the debtor's plan because the test was satisfied; concluding that all five factors were met); *In re* Hoffinger Indus., Inc., 321 B.R. 498, 513–14 (Bankr. E.D. Ark. 2005) (adopting the test, but rejecting the actual release contained in the debtor's plan because none of the five factors were satisfied).

For decisions adopting the test in the Eleventh Circuit, see *In re* Optical Tech., Inc., 216 B.R. 989, 990–94 (M.D. Fla. 1997) (expressly adopting the *Master Mortgage* test but striking the actual releases contained in the plan because the plan provided for the liquidation of the debtors rather than reorganization, did not provide payment for substantially all of the released claims, and there was no identity of interest between the third parties and the debtors); *In re* Transit Group, Inc., 286 B.R. 811, 816–20 (Bankr. M.D. Fla. 2002) (adopting the test and holding that only one of the non-debtor releases contained in the plan was permissible because the third parties shielded by the other releases did not contribute to the plan or did not show that their release was necessary).

further group has assessed the propriety of non-debtor releases using similar factors.[299] But the authorities are not uniform in their understanding of the test. For example, some cases indicate that the five elements should be balanced.[300] Others suggest that each of the five must be satisfied.[301] Still others have added to the test. The Sixth Circuit recently included a sixth factor: all *dissenting* creditors whose claims are extinguished by the release must be paid in full under the plan.[302] The courts following *Master Mortgage* do agree on

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Some courts have used the test in assessing the validity of a provisional injunction. *See, e.g.*, *In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673757, at *8-*11 (Bankr. M.D.N.C. Feb. 24, 2000) (applying the *Master Mortgage* test in holding that the provisional injunction contained in the debtor's plan was permissible under the Code because each of the five factors was satisfied); *In re* Shaw Aero Devices, Inc., 283 B.R. 349, 350–53 (Bankr. M.D. Fla. 2002) (applying the *Master Mortgage* test in holding that a non-debtor release, which the court construed to operate as a provisional injunction, was permissible where four of the five factors were satisfied).

[299] *See, e.g.*, Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 975–76, 985 (1st Cir. 1995) (the bankruptcy court, whose confirmation opinion is attached as an appendix to the First Circuit decision, approved of a broad non-debtor release barring nearly all claims against numerous third parties, including the debtor's attorneys, directors, employees, and agents, that related to the debtor's operations where the third parties contributed substantial funds to the plan, the creditors "overwhelmingly consented," and the non-debtor release was "the only basis on which to build, confirm and effectuate the Plan"); Monarch Life Ins. Co. v. Ropes & Gray (*In re* Monarch Capital Corp.), 173 B.R. 31, 41–43 (D. Mass. 1994) (affirming the *Monarch Life Ins.* bankruptcy court's granting of the non-debtor releases), *aff'd*, 65 F.3d 973 (1st Cir. 1995); *In re* Trans World Airlines, Inc., 185 B.R. 302, 313, 321–22 (Bankr. E.D. Mo. 1995) (holding that the non-debtor releases in the plan of reorganization were permissible under §§ 105(a) and 1123(b)(6) and other "applicable law," where there was an "absence of objections" to the releases, all impaired classes supported the plan, the released parties gave up valuable rights against the debtor, the debtor had indemnified the third parties from the released claims, and there was no evidence that the non-debtors faced any liability on the released claims); *see also* Buschman, *supra* note 27, at 942, 946 (approving of non-debtor releases where (1) the injunction is indispensable to the reorganization because it facilitates an increase in estate assets earmarked for distribution to creditors, (2) does not bar claims against non-contributing third parties, and (3) the non-debtor's contributions "bear a reasonable relation to their potential liability (in the case of insurers) or their net worth (in the case of general partners)"); Swallow, *supra* note 27, at 709, 726 (arguing that non-debtor releases are permissible under § 1123(b)(6) where (1) the plan provides payment in full on all extinguished claims, (2) the non-debtor release is essential to the plan—i.e., without the release the creditors will recover substantially less and a confirmable plan cannot be formulated, and (3) a substantial majority of creditors support the plan); *cf.* Lewis, *supra* note 27, at 176 (maintaining that third-party releases are allowable where creditors receive full payment on all claims eliminated by the release).

[300] *See, e.g., Master Mortgage*, 168 B.R. at 935 ("The courts seem to have balanced the five listed factors most often."); *In re* Transit Group, Inc., 286 B.R. 811, 817–18 (Bankr. M.D. Fla. 2002) (suggesting that not all factors need be present to justify a non-debtor release).

[301] *See, e.g.*, Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002) (holding that a non-debtor release is "appropriate" under § 1123(b)(6) only where all five *Master Mortgage* factors are satisfied and where every dissenting creditor with claims affected by the release is paid in full); Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989) (implying that all of the factors the court considered in upholding the non-debtor release were necessary to avoid the impact of § 524(e)).

[302] *Dow Corning Corp.*, 280 F.3d at 658 (adopting the test but remanding because the factual findings of the bankruptcy court did not support a finding that unusual circumstances existed justifying the non-debtor

one thing, however: non-debtor releases should only be granted in "exceptional" or "unusual" circumstances because they are a "drastic" form of relief.[303] Indeed, the *Master Mortgage* approach has been called the "unusual circumstances test."[304]

Although many pro-release courts have adopted some version of the *Master Mortgage* test, others apply a less stringent standard when addressing the propriety of non-debtor releases. The leading case in this line of authority is *In re Drexel Burnham Lambert Group, Inc.*[305] Drexel and eighteen of its subsidiaries were driven into bankruptcy, in large part, by class action and derivative lawsuits for securities violations brought on behalf of "tens of thousands" of persons.[306] Prior to confirmation of the plan, the district and bankruptcy courts certified a mandatory non-opt-out class under Rule 23(b)(1)(B)[307] that consisted of all securities claimants.[308] The judges also granted approval to a settlement between the class and the debtors that provided for payments to the securities claimants through the debtors' plan of

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releases). The Sixth Circuit articulated a seventh factor as well—that the bankruptcy court make specific factual findings that support its conclusion as to the other six elements. *Id.* But this is technically not an additional factor. It simply mandates that the bankruptcy court make a record in its assessment of the six elements.

303 *See, e.g.*, *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 937 (W.D. Mo. 1994) ("The Court cautions the Gentle Reader that a permanent injunction is a rare thing, indeed, and only upon a showing of exceptional circumstances in which the factors outlined above are present will this Court even entertain the possibility of a permanent injunction."); Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002) ("Because such an injunction is a dramatic measure to be used cautiously, we follow those circuits that have held that enjoining a non-consenting creditor's claim is only appropriate in 'unusual circumstances.'"); *In re* Transit Group, Inc., 286 B.R. 811, 818 (Bankr. M.D. FL. 2002) ("Moreover, allowing non-debtor releases is the exception, not the norm. Debtors should not automatically expect to release officers, directors, insurers, or creditors from future liability, unless some extraordinary reason is proven."); *id.* at 820 ("Non-debtor releases are extraordinary and should be reserved for unusual circumstances."); *id.* at 817 ("[T]he courts allowing non-debtor releases hold that the granting of such releases is justified only in unusual circumstances."); *In re* Am. Family Enters., 256 B.R. 377, 406 (D.N.J. 2000) (interpreting *Robins* and its progeny as allowing for non-debtor releases only in "exceptional or extraordinary circumstances"); *see also* Deutsche Bank AG v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 143 (2d Cir. 2005) ("A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan . . . .").

304 *See* Greenblatt v. Richard Potasky Jeweler, Inc. (*In re* Richard Potasky Jeweler, Inc.), 222 B.R. 816, 826 (S.D. Ohio 1998).

305 SEC v. Drexel Burnham Lambert Group, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 960 F.2d 285 (2d Cir. 1992).

306 *See* SEC v. Drexel Burnham Lambert, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 130 B.R. 910, 913–14 (S.D.N.Y. 1991), *aff'd* 960 F.2d 285 (2d Cir. 1992).

307 FED. R. CIV. P. 23(b)(1)(B).

308 *Drexel Burnham Lambert,* 130 B.R. at 914, 918, 923–24.

reorganization and released most of the class's securities claims against the debtors' directors and officers.[309] In support of this ruling, the lower courts explained that the settlement and non-debtor release were essential to the reorganization because, without them, "there could be no Plan and indeed, no successful and prompt resolution of these chapter 11 cases."[310] More specifically, the judges found that the non-debtor release would (1) facilitate cooperation between the debtors and their employees, (2) induce the debtors' directors and officers to settle certain claims with the debtors, which would provide more funds for the reorganization, (3) eliminate competition over particular assets, and (4) protect the debtors' estate by preventing indemnity claims that insiders would assert if they were sued by the securities claimants.[311]

On appeal, the Second Circuit overruled the objections challenging the non-debtor releases.[312] Citing *Robins*, the court of appeals stated, with no additional analysis, that "[i]n bankruptcy cases, a court may enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan."[313] The court continued by determining that the settlement "is unquestionably an essential element of Drexel's ultimate reorganization[,]" and that the non-debtor release "is a key component of" that agreement.[314] Without it, the directors and officers would be less likely to settle.[315]

Drexel is a substantial extension of *Robins*. The standard it proposes—whether a non-debtor release "plays an important part in the debtor's reorganization plan"[316]—is not nearly as rigorous as the *Master Mortgage* test.[317] And while there is evidence that four of the *Master Mortgage* elements

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309 *Id.* at 924–28; *Drexel Burnham Lambert,* 960 F.2d at 288–89.

310 *Drexel Burnham Lambert,* 130 B.R. at 926–27.

311 *Id*. at 928.

312 *Drexel Burnham Lambert Group*, 960 F.2d at 293.

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

314 *Drexel Burnham Lambert,* 960 F.2d at 293.

315 *Id.*

316 *Id.*

317 *See* Brubaker, *supra* note 27, at 1022 (noting that the *Drexel* court's standard for acceptance of non-debtor releases is less strict than the test adopted by most pro-release courts). *But cf.* Deutsche Bank AG v. Metromedia Fiber Network, Inc. (*In re* Metromedia Fiber Network, Inc.), 416 F.3d 136, 143 (2d Cir. 2005) ("A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan . . . .").

were satisfied in *Drexel*,[318] there clearly was no payment in full.[319] Nonetheless, the *Drexel* test is now controlling in the Second Circuit,[320] and in at least one other jurisdiction.[321]

[318] The securities claimants overwhelmingly supported the settlement. *Drexel Burnham Lambert*, 130 B.R. at 923. Furthermore, the courts concluded that the non-debtor release was essential to the reorganization., *id.* at 926–28; *Drexel Burnham Lambert*, 960 F.2d at 293, and that there was a threat of indemnity actions, 130 B.R. at 928; 960 F.2d at 293. Finally, the settlement of the lawsuits between the debtors and the directors and officers provided additional funds for the plan, 130 B.R. at 928, 960 F.2d at 293, and one could construe the settlement payments to be contributions by the non-debtors. *But see In re* Mahoney Hawkes, LLP, 289 B.R. 285, 300 (Bankr. D. Mass. 2002) (ruling that an insurance company's payment to the estate under the debtor's policy did not satisfy the "substantial contribution" element of the *Master Mortgage* test because the insurance company was "only fulfilling its contractual obligation").

[319] *Drexel Burnham Lambert*, 130 B.R. at 913–14, 920 (indicating that the value of the securities claimants' claims exceeded the assets of the debtors by roughly a multiple of ten); *id.* at 925 (stating that the debtors did not have sufficient funds to pay more than the amount put forth in the settlement). Indeed, Rule 23(b)(1)(B) mandatory non-opt-out classes are intended for use where the assets available for the class members constitute a limited fund, insufficient to pay all claimants in full. *See In re* Federal Skywalk Cases, 680 F.2d 1175, 1187 (8th Cir. 1982) ("A class action may be certified under Rule 23(b)(1)(B) when a number of individuals claim rights to a share of a fund that is too small to satisfy in full every individual's claim."). Thus, the "nature of [the *Drexel* class action] settlement implicitly recognized the fact that [the securities claimants] were not being fully compensated." Brubaker, *supra* note 27, at 989. Professor Brubaker provides devastating criticism of *Drexel* in his article. He illustrates how the use of the mandatory non-opt-out class wholly subverted critical protections contained in the Bankruptcy Code. *See id.* at 988–89.

[320] *See, e.g.*, Cartalemi v. Karta Corp. (*In re* Karta Corp.), 342 B.R. 45, 54–57 (S.D.N.Y. 2006) (following *Drexel* and largely approving of a non-debtor release extinguishing claims against principals of the debtors and several related entities because the reorganization plan preserved the debtors' business operations, the plan was made possible by the principals' substantial financial contributions, and the principals refused to make the contributions without the release); Abel v. Shugrue (*In re* Ionosphere Clubs, Inc.), 184 B.R. 648, 655 (S.D.N.Y. 1995) (holding that non-debtor releases are permissible "to resolve finally all claims in connection with the estate and to give finality to a reorganization plan") (approving of several non-debtor releases where they were integral to a final resolution of claims in connection with the estate and to give finality to the reorganization plan); LTV Corp. v. Aetna Cas. & Sur. Co. (*In re* Chateaugay Corp.), 167 B.R. 776, 780 (S.D.N.Y. 1994) (holding that bankruptcy courts may issue non-debtor releases under § 105(a) if they are "essential" to the plan of reorganization, but remanding and directing the bankruptcy court to more carefully consider whether the non-debtor release in the plan satisfied this standard); Greer v. Gaston & Snow (*In re* Gaston & Snow), Nos. 93 Civ. 8517 (JGK), 93 Civ. 8628 (JGK), 1996 WL 694421, at *2-*5 (S.D.N.Y. Dec. 4, 1996) (following *Drexel* in holding that non-debtor releases are permissible where they play "an important part in the debtor's reorganization plan") (concluding that third-party releases that extinguished all partner contribution and indemnity claims against partners that contributed to the estate of the debtor-partnership "clearly played an important part in the plan" because no partner would have contributed without the protection of the release); *In re* Spiegel, Inc., No. 03-11540 (BRL), 2005 WL 1278094, at *11, *15-*17 (Bankr. S.D.N.Y. May 25, 2005) (following *Drexel*); *see also* Myerson & Kuhn v. Brunswick Assoc. Ltd. P'ship (*In re* Myerson & Kuhn), 121 B.R. 145, 150, 154–57 (S.D.N.Y. 1990) (suggesting that the debtor-partnership's plan could include a non-debtor release barring the debtor's creditors and partners from suing partners that contributed to the debtor's estate as part of the plan because the release was necessary to the formulation of a workable plan; further noting that the release may be permissible even though the creditors would not be paid in full if the contributing partners only paid on the basis of their net worth and the substantive validity of any claims against them).

While pro-release courts have used various standards to assess the legitimacy of non-debtor releases, this Article maintains that releases must satisfy a modified version of the *Master Mortgage* "unusual circumstances" test. In my view, a bankruptcy court may grant a third-party release only if the first ("identity of interest") and third ("essential to the reorganization") *Master Mortgage* factors are met, the impacted class of creditors "accepts" the plan as that concept is defined by § 1126(c) of the Code,[322] and all dissenting creditors affected by the release are to be paid in full on their extinguished claims. Unless each of these four elements is fulfilled, the non-debtor release is invalid and the issues that are the primary focus of this Article—(1) the scope of

321 *See In re* McCall, No. 93-00632, 1997 WL 428580, at *16 (Bankr. D.D.C. May 27, 1997) ("Estate creditors may be permanently enjoined from instituting collection actions against non-debtors who are jointly liable with the debtor on estate debts when the non-debtor co-obligors make financial contributions to the estate that are an essential source of funding for a reorganization plan.") (upholding a channeling release); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 666–67, 685–87 (Bankr. D.D.C. 1992) ("Under section 105(a) a bankruptcy court may enter a permanent injunction enjoining suits against non-debtor parties funding a plan of reorganization if the court finds that such an injunction is essential to effectuate the plan of reorganization.") (confirming a plan containing a non-debtor release that extinguished the contribution and indemnity claims that partners, who did not contribute assets to the estate, could assert against contributing partners, where the release was the "sin qua non of the plan").

As a final note, a few courts have approved of non-debtor releases using tests wholly distinct from those in the *Master Mortgage* and *Drexel* lines. *See* Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 305–08 (Bankr. E.D. Pa. 1999) (using the test for non-debtor *stays* set forth in *In re* Monroe Well Serv. Inc., 67 B.R. 746, 750–57 (Bankr. E.D. Pa. 1986), in issuing a postconfirmation non-debtor release of partners who had provided assets to the debtor-partnership's estate pursuant to a settlement with the debtor); Munford v. Munford, Inc. (*In re* Munford, Inc.), 97 F.3d 449, 452, 455 (11th Cir. 1996) (holding that where the debtor settled with a defendant in an adversary proceeding, the bankruptcy court could issue a permanent injunction under § 105(a) and FED. R. CIV. P. 16(c)(9) that barred the non-settling defendants from asserting contributing and indemnity claims against the settling defendant because the injunction was necessary to effectuate the settlement). While some courts have included *Munford* in the pro-release camp, *see, e.g.*, *In re* Transit Group, Inc., 286 B.R. 811, 816 n.2 (Bankr. M.D. Fla. 2002), the case involved relatively unique circumstances. Most non-debtor releases bar a *creditor* of the debtor from pursuing a *co-obligor* of the debtor. But the release in *Munford* prohibited parties *liable to the debtor* from suing other such parties, where the injunction was necessary to induce the settling defendant to compromise and the settlement saved estate assets. *Munford*, 97 F.3d at 452, 454–55. Critically, the court of appeals did not cite any pro- or anti-release cases; and it focused heavily on Federal Rule of Civil Procedure 16(c)(9) (providing that a court may use "special procedures to assist in" promoting settlement) in analyzing the propriety of the release. *Munford*, 97 F.3d at 454–55. Accordingly, it is not clear whether the Eleventh Circuit would extend its reasoning in *Munford* to the more typical non-debtor release context. *Cf. In re* Optical Tech., Inc., 216 B.R. 989, 990–94 (M.D. Fla. 1997) (failing to discuss or cite *Munford* in analyzing whether to adopt the *Master Mortgage* test).

322 11 U.S.C. § 1126(c) (2000) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan.").

authority conferred by §§ 105(a) and 1123(b)(6), and (2) whether § 524(e) bars releases—do not even arise.[323]

Element One—"Identity of Interest." First, an "identity of interest" is required to establish subject matter jurisdiction over the claims that are eliminated by the release. If the debtor and the third party do not have such a relationship, any lawsuit against the third party will have no impact on the estate, placing the underlying claim beyond the jurisdiction of the bankruptcy court.[324] And a bankruptcy court may not extinguish a claim over which it lacks jurisdiction.[325]

Element Two—"Essential to the Reorganization." Second, §§ 105(a) and 1123(b)(6) mandate that non-debtor releases be "essential to the reorganization." The former law only permits a court to issue orders "necessary or appropriate to carry out the provisions of" the Code.[326] And the latter allows a plan of reorganization to include "any other appropriate provision not inconsistent with the applicable provisions of this title."[327] Because non-debtor releases are a drastic form of relief,[328] it is difficult to imagine why a release would be "necessary" or "appropriate" if it is not *essential* to the reorganization.[329]

Under the test proposed here, the primary method of demonstrating that a non-debtor release is essential is by showing that contributions from third parties are necessary to the formulation of a workable plan and are contingent

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323 In addition, nothing beyond these four elements is necessary.

324 *See* Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984) (holding that bankruptcy courts have jurisdiction over claims that "could conceivably have any effect on the estate being administered in bankruptcy") (italics removed); *see also supra* note 38 and *infra* note 357 for brief discussions of the jurisdictional issues relating to non-debtor releases.

325 *See* Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 624 (9th Cir. 1989) (noting that subject matter jurisdiction is a prerequisite to a bankruptcy court's capacity to act); *see also* Wasserman v. Immormino (*In re* Granger Garage, Inc.), 921 F.2d 74, 77 (6th Cir. 1990) (§ 105(a) is not a jurisdictional provision).

326 § 105(a).

327 § 1123(b)(6).

328 *See supra* note 303 and accompanying text.

329 *See* Brubaker, supra note 27, at 1022 (concluding that "nothing short" of a showing of necessity could justify a non-debtor release); *see also* United States v. Energy Res. Co. 495 U.S. 545, 548–50 (1990) (holding that bankruptcy courts may issue tax designation orders under §§ 105(a) and 1123(b)(6) "if the bankruptcy court determines that this designation is *necessary* to the success of a reorganization plan") (emphasis added). For additional discussion of the similarities between the modified *Master Mortgage* test proposed in the text and the standard used by the Supreme Court in *Energy Resources*, see *infra* note 533.

upon the third parties receiving a release.[330] But this is not the only way to establish that a release is essential. The reorganization may hinge upon the debtor being free from indemnity and contribution claims,[331] which can consume precious estate resources, inhibiting the debtor's rehabilitation. Alternatively, critical employees of the debtor might refuse to continue working in the absence of a release, making it impossible for the debtor to emerge from bankruptcy and resume its operations.[332] Accordingly, contributions from the released parties are not necessary in all cases, and thus the second *Master Mortgage* factor (a "substantial" contribution to the estate by released third parties) is not mandatory.

Additionally, the second element cannot be satisfied unless the debtor is actually reorganizing. Debtors *liquidating* under chapter 11 do not receive a discharge.[333] Neither do corporations and other artificial persons disposing of their property in a chapter 7 proceeding.[334] Bankruptcy courts should not be permitted to extinguish non-debtor liabilities in a case where the Code denies any such relief to the debtor itself.[335] That is because a non-debtor release that

[330] *See, e.g.*, *In re* Am. Family Enter., 256 B.R. 377, 391–92 (D.N.J. 2000) (contributions of third parties that made possible (1) significant distributions to creditors, and (2) the continued operation of the debtors, were contingent upon the third parties obtaining releases); *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 938 (Bankr. W.D. Mo. 1994) (without a release, the non-debtors would not have made contributions that enabled the debtor to formulate a workable plan and allowed creditors to recover in full).

[331] *See, e.g.*, Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989). *But see* Brubaker, *supra* note 27, at 1002–09 (asserting that contribution and indemnity claims do not threaten the estate in the manner that pro-release courts and commentators suggest).

[332] *See, e.g.*, *In re* Shaw Aero Devices, Inc., 283 B.R. 349, 352–53 (Bankr. M.D. Fla. 2002) (upholding a non-debtor release, which the court construed to operate as a provisional injunction, because, *inter alia*, while the beneficiary of the release was not contributing money to the plan, the beneficiary's participation in the future operations of the debtor was "necessary . . . to consummate the Plan of Reorganization"); *see also* United States v. A&B Heating & Air Conditioning, Inc. (*In re* A&B Heating & Air Conditioning), 823 F.2d 462, 465 (11th Cir. 1987) ("Frequently, the efforts put forth by [the] officers during the reorganization is the corporation's only hope for future viability."), *vacated*, 486 U.S. 1002 (1988).

[333] 11 U.S.C. § 1141(d)(3)(A) (2000) ("The confirmation of a plan does not discharge a debtor if . . . the plan provides for the liquidation of all or substantially all of the property of the estate."). As § 1141(d)(3) makes clear, chapter 11 expressly contemplates liquidating plans of "reorganization." § 1141(d)(3).

[334] § 727(a)(1) ("The court shall grant the debtor a discharge, unless . . . the debtor is not an individual . . . ."); Wetherbee v. Willow Lane, Inc. (*In re* Bestway Products, Inc.), 151 B.R. 530, 537 (Bankr. E.D. Cal. 1993) ("It is a crystalline rule that a discharge cannot be entered in a Chapter 7 case in which the debtor is not an individual."), *aff'd*, 165 B.R. 339 (B.A.P. 9th Cir. 1994).

[335] *See In re* Optical Tech., Inc., 216 B.R. 989, 990–94 (M.D. Fla. 1997) (adopting *Master Mortgage* but striking the actual releases contained in the debtors' liquidating plan because "where . . . a plan of reorganization provides for the total liquidation of the debtor, the factors of *Master Mortgage* cannot be met"); *In re* Mrs. Weinberg's Kosher Foods, 278 B.R. 358, 365–66 (Bankr. S.D.N.Y. 2002) (holding in this chapter 7 case that bankruptcy courts may not use a channeling injunction to enjoin a creditor from prosecuting direct claims against a non-debtor); *In re* Mahoney Hawkes, LLP, 289 B.R. 285, 302 (Bankr. D. Mass. 2002)

is part of a liquidation does not serve the "conventional purposes of the reorganization policy," such as preserving jobs and protecting broader community interests.[336] Rather, it simply promotes the more narrow bankruptcy policy of maximizing the debtor's estate for distribution to creditors.[337] Therefore, non-debtor releases are inappropriate in chapter 7 and chapter 11 liquidations. In short, "essential to the reorganization" means essential to the *reorganization*.[338]

Element Three—"Consent by Impacted Creditors." Third, when the class of creditors affected by a non-debtor release has "accepted" the plan under § 1126(c), the debtor need not satisfy the requirements of the Code's "cramdown" provision. Section 1129(a) states that a plan may be confirmed only if each "impaired" class of creditors has accepted the plan.[339] However,

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(concluding that a proposed actual release did not satisfy the *Master Mortgage* test because, *inter alia*, the debtor intended to file a liquidating chapter 11 plan); *In re* Swallen's, Inc., 210 B.R. 123, 127 (Bankr. S.D. Ohio 1997) (concluding that even if the court adopted the *Master Mortgage* test, the proposed non-debtor release was impermissible because, *inter alia*, the debtor was liquidating under chapter 11 and thus the release could not be essential to a reorganization); *cf. In re* Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (holding that the court did not have sufficient power under § 105(a) to grant a non-debtor release that extinguished the contractual rights of a non-debtor shareholder that was co-insured with the debtor and distinguishing *Johns-Manville*, in part, because the debtor here proposed a liquidating plan rather than a reorganization), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992).

[336] Brubaker, *supra* note 27, at 1014–16, 1019; *see also* Boyle, *supra* note 27, at 439 ("Indeed, Congress has indicated in the Code's legislative history that the purpose of a reorganization is to rehabilitate the debtor so that it may continue to provide its employees with jobs, satisfy its debts to its creditors, and yield a return to its shareholders.").

[337] Brubaker, *supra* note 27, at 1019.

[338] Admittedly, a significant number of cases have approved of non-debtor releases contained in chapter 11 liquidating plans. *See, e.g.*, Greer v. Gaston & Snow (*In re* Gaston & Snow), Nos. 93 Civ. 8517 (JGK), 93 Civ. 8628 (JGK), 1996 WL 694421, at *2-*5 (S.D.N.Y. Dec. 4, 1996) (holding that the non-debtor releases in the debtor-partnership's liquidating chapter 11 plan were valid); Abel v. Shugrue (*In re* Ionosphere Clubs, Inc.), 184 B.R. 648, 654–55 (S.D.N.Y. 1995) (upholding a non-debtor release contained in the corporate debtors' chapter 11 liquidating plan); Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 283, 305 (Bankr. E.D. Pa. 1999) (approving of a postconfirmation permanent injunction even though the debtor-partnership filed a chapter 11 liquidating plan); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 666–68, 685–87 (Bankr. D.D.C. 1992) (same).

[339] 11 U.S.C. § 1129(a)(8) (2000). A class of claims is "impaired under § 1124 if the plan alters the legal, equitable or contractual rights to which holders of such claims are otherwise entitled." 7 COLLIER ON BANKRUPTCY ¶ 1124.01, at 1124–3 (Lawrence P. King ed., 15th ed. rev. 2003); *see also* § 1124(1). "*Any* alternation of these rights constitutes impairment, even if the value of the rights is *enhanced*." 7 COLLIER ¶ 1124.02, at 1124–5 (emphasis added) (collecting authorities). In other words, even if a claim is paid in full under the plan, if the claim is changed in any way—e.g., the plan provides that a contractual claim will be paid more slowly than originally agreed—the claim is impaired. *See* Oxford Life Ins. Co. v. Tucson Self-Storage, Inc. (*In re* Tucson Self-Storage, Inc.), 166 B.R. 892, 895 n.5 (9th Cir. B.A.P. 1994) (holding that a class' claims were impaired because they were to be paid in full sixty days after the effective date of the plan rather than immediately upon the effective date as was their right under nonbankruptcy law).

§ 1129(b) creates an exception: a plan may be confirmed over the objection of an impaired class (i.e., "crammed down")[340] if the plan "does not discriminate unfairly" against the class and treats the class in a "fair and equitable" manner.[341] These standards are exceptionally demanding,[342] and a plan containing a non-debtor release probably could not satisfy them.[343] In fact, several years after confirmation, a bankruptcy court in *Robins* noted that the debtor's plan would have been "unconfirmable" under § 1129(b) if the Dalkon Shield claimants had voted against the plan and there was *any* chance that they would not receive payment in full.[344] Thus, a third-party release will not pass muster if the impacted class objects.[345]

Critically, this proposed requirement of class consent is distinct from the fourth *Master Mortgage* factor—that the class affected by the release has "'overwhelmingly' voted to accept the proposed plan treatment."[346] This Article contends that if the impacted class has "accepted" the plan pursuant to

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340 7 COLLIER ON BANKRUPTCY ¶ 1129.04, at 1129–75 (Lawrence P. King ed., 15th ed. rev. 2004).

341 § 1129(b)(1).

342 7 COLLIER ¶ 1129.04, at 1129–75 ("The requirements of section 1129(b) . . . are both numerous and exacting.").

343 *See* Feldstein, *supra* note 27, at 43 ("It should never be fair or equitable to confirm a plan requiring a dissenting class to release a nondebtor from a claim not held by other classes."); *see also In re* Salem Suede, Inc., 219 B.R. 922, 927–28, 931–37 (Bankr. D. Mass. 1998) (holding under § 1129(b)(1) that a non-debtor release unfairly discriminated against the class of creditors affected by the release because other creditors did not need to give up rights against third parties to receive distributions under the plan). The main problem is that, in relation to provisional injunctions, non-debtor releases shift the risk of plan failure from the benefited third party to the impacted creditor. *See supra* notes 76–77 and accompanying text. This feature of non-debtor releases is particularly likely to run afoul of the fair and equitable standard. *Cf.* 7 COLLIER ¶ 1129.04[4][b][ii], at 1129-107 (observing that courts have concluded that the fair and equitable requirement prohibits the "unfair and unreasonable shifting of risk" of plan failure from junior classes to senior classes). *But see In re* McCall, No. 93-00632, 1997 WL 428580, at *16 (Bankr. D.D.C. May 27, 1997) (approving of a channeling release over the objection of several impaired classes and expressly finding that the provision was fair and equitable under § 1129(b)).

344 *In re* A.H. Robins Co., 129 B.R. 457, 460 (Bankr. E.D. Va. 1991); *see generally* Aetna Realty Investors, Inc. v. Monarch Beach Venture, Ltd. (*In re* Monarch Beach Venture, Ltd.), 166 B.R. 428, 436 (C.D. Cal. 1993) ("This Court holds that, to be fair and equitable, a plan of reorganization cannot unfairly shift the risk of a plan's failure to the creditor.") (collecting authorities); *accord In re* Prussia Assoc., 322 B.R. 572, 595 (Bankr. E.D. Penn. 2005).

345 Creditors impacted by a non-debtor release must be placed in a distinct class (or classes, if the release extinguishes different types of claims). Including them in a class with other creditors "undermines the Bankruptcy Code's classification and treatment scheme" set forth in §§ 1122(a), 1123(a)(4). Brubaker, *supra* note 27, at 983; *see also id.* at 981–86 (arguing that third-party releases frequently corrupt the integrity of class formation and treatment because courts do not take the extinguished non-debtor claims into account in analyzing whether the plan of reorganization satisfies §§ 1122(a) and 1123(a)(4)); *id.* at 990–91 (third-party releases weaken the "cramdown" protections set forth in § 1129(b) by "infect[ing] the soundness of the classification system").

346 *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994).

§ 1126(c) of the Code, no additional creditor consent, overwhelming or otherwise, is necessary. And under § 1126(c) "[a] class of creditors has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan."[347]

Element Four—"Payment in Full to Dissenting Creditors." Fourth and last, payment-in-full for *dissenting* creditors whose claims are extinguished by the non-debtor release is required by the "best-interests-of-creditors test."[348] Under that test, a chapter 11 plan of reorganization may only be confirmed if it provides each dissenting creditor at least as much as the claimant would receive if the debtor liquidated under chapter 7.[349] In a chapter 7 proceeding, a creditor may recover any deficiency from a solvent co-obligor if the liquidation distribution does not completely satisfy the creditor's claim.[350] Therefore,

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[347] 11 U.S.C. § 1126(c) (2000).

[348] It has been suggested that payment in full for dissenting creditors on any extinguished claims is the most important factor when considering the validity of a non-debtor release. *See In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673784, at *8 (Bankr. M.D.N.C. Mar. 8, 2000) ("A careful reading of [*Robins*] reflects that perhaps the most important consideration prompting the decision was that the nondebtors who were being enjoined could obtain full payment of their claims under the plan of reorganization."); Meltzer, *supra* note 27, at 26 ("After all, the only reason to be concerned about the issue in the first place is presumably if the debtor's plan does not make provisions for full payment of the creditor's claim and that creditor wants to obtain its deficiency or its damages from third parties."); *see also* Lewis, *supra* note 27, at 170, 176 (concluding that § 524(e) bars non-debtor releases unless the creditors receive payment in full on any discharged debts); Han, *supra* note 27, at 554, 579 (arguing that non-debtor releases are permissible under § 105(a) only where holders of any released claims are paid in full under the plan); Swallow, *supra* note 27, at 709 (concluding that non-debtor releases are permissible where the plan provides for payment in full on all extinguished claims). *But see In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 938 (Bankr. W.D. Mo. 1994) ("The Court considers this [creditor approval] the single most important factor."). It should be noted that Meltzer adds a corollary, arguing that non-debtor releases are permissible only where the creditor is paid in full on its claim *at the time the plan is confirmed*. *Id.* at 26 n.83, 41.

[349] § 1129(a)(7); 7 COLLIER ON BANKRUPTCY ¶ 1129.03[7][e], at 1129–56 (Lawrence P. King ed., 15th ed. rev. 2004). Unlike the cramdown provisions in § 1129(b), which protect *classes* of creditors, *see In re* Sentry Operating Co. of Texas, Inc., 264 B.R. 850, 865 (Bankr. S.D. Tex. 2001), the best-interests test protects *individual* creditors, *see In re* Cajun Elec. Power Cooperative, Inc., 230 B.R. 715, 741 (Bankr. M.D. La. 1999) (the best-interests test "is designed to protect those individual creditors who voted against a particular plan, but who, nonetheless, are being bound to such plan").

[350] *See* Brubaker, *supra* note 27, at 992 ("In a Chapter 7 liquidation proceeding, creditors retain their rights to pursue non-debtors for full payment, because there is no reorganization to protect by providing non-debtor releases."); Feldstein, *supra* note 27, at 43 ("Where a creditor holds, or creditors generally hold, claims against a nondebtor, § 524(e) . . . would preserve those claims and they would survive a chapter 7 discharge of the debtor pursuant to § 524(a)."); *see also* § 723(a) (providing that if the estate of a bankrupt *partnership* can not pay all claims in full, the trustee may pursue general partners for any deficiency to the extent permitted under nonbankruptcy law). The assumption here is that non-debtor releases are impermissible in chapter 7 bankruptcies, a correct assumption in my view. *See supra* notes 333–38 and accompanying text.

since the dissenting creditor would receive payment in full on its claim in a chapter 7 bankruptcy from either the debtor, the co-obligor, or a combination of the two, the dissenting creditor must receive full payment under the debtor's chapter 11 plan of reorganization if the codebtor receives a release. Otherwise, the plan violates the best-interests test.[351] As a result, only channeling releases are permissible; actual releases are forbidden.

Professor Brubaker, in his immensely thorough article on non-debtor releases, is particularly critical of actual releases. His fundamental objection is that actual releases extract value from a creditor of the non-debtor against the creditor's will, and then redistribute that value to other parties, such as the releasee, the debtor, and the debtor's other creditors and shareholders.[352] In

[351] *See* Brubaker, *supra* note 27, at 991–94 (arguing that non-debtor releases violate the best-interests-of-creditors test); *id.* at 992 ("[G]iving at least liquidation value to each creditor requires protection of the Chapter 7 right to pursue non-debtor actions."); Lewis, *supra* note 27, at 174–75 (arguing that a plan containing a non-debtor release does not satisfy the best-interests test if the co-obligors have sufficient assets to satisfy any deficiencies on the discharged claims); *see also In re* Boston Harbor Marina Co., 157 B.R. 726, 732 (Bankr. D. Mass. 1993) ("Indeed, because a chapter 7 trustee of [a] partnership may proceed against the partners individually, 11 U.S.C. § 723 (1988), the best-interest-of-creditors test . . . requires the court to find that creditors will receive at least as much from the partners' contributions to the [partnership's] plan as they would from the assertion of a chapter 7 trustee's rights against the partners," if the plan releases the partners.); Feldstein, *supra* note 27, at 43 ("Accordingly, if the claims released have any real value, then the best interest test requires realization of that value for the plan to be confirmed."); *cf.* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002) (holding that non-debtor releases are permissible only when all dissenting creditors whose claims are extinguished by the release are paid in full under the debtor's plan). The same analysis applies if the debtor and the third party are not co-debtors—i.e., where the debtor has no personal liability for the claim against the third party. Clearly the creditor would receive compensation in full on such a claim from the non-debtor if the debtor liquidated. Thus, when a debtor's chapter 11 plan purports to extinguish an independent claim against a third party, the best-interests test mandates payment in full for the claimholder.

[352] Professor Brubaker articulates this point numerous times throughout his article. *See, e.g.*, Brubaker, *supra* note 27, at 989 ("The ultimate injury non-debtor releases visit upon creditors is distributional. Creditors without valuable non-debtor rights can take value away from creditors whose valuable non-debtor rights are extinguished through non-debtor releases."); *id.* at 1001 ("What non-debtor releases take from creditors holding valuable non-debtor claims, they give to (1) the released non-debtors and their other creditors, and/or (2) creditors and shareholders of the Chapter 11 debtor without valuable non-debtor rights."); *id.* at 1008 (noting that particular arguments purportedly in favor of non-debtor releases cannot justify the "categorical elimination of certain types of disputed claims" because that requires "an additional policy judgment that certain creditors are more worthy of payment than others—a choice that violates basic creditor equality principles and that should be reserved for Congress"); *id.* at 1009 (explaining that choosing between a third party's contribution or indemnity claim against the debtor and the creditor's claim against the third party, a choice inherent in non-debtor releases, "punctuates the essential distributional policy judgments implicit in judges' approval of non-debtor releases"); *id.* at 1013 (arguing that "the redistribution of value inherent in non-debtor releases" undermines Code policies of creditor equality); *id.* at 1021 ("Thus, the reorganization policy often adds very little to the debate concerning non-debtor releases and, at its worst, seems to be a vacuous and pretextual cover for the redistributional effects of non-debtor releases."); *id.* at 1038 (maintaining that a release that "channels" a creditor's claims against a non-debtor to the debtor's estate does so "without any assurance

addition to violating the Code, this undermines the policies of some nonbankruptcy laws, such as joint and several liability and guarantee law.[353]

But if the debtor's plan provides the dissenting creditor with payment in full, the redistributional consequences of any non-debtor release largely evaporate. Unlike actual releases, channeling releases neither strip creditors of their claims, nor force them to impart value to other parties over their objection.

As with the creditor consent element, the suggested payment-in-full requirement deviates from *Master Mortgage*. If a creditor votes in favor of a plan containing a release, it is not given the protection of the best-interests test.[354] More importantly, any such release is consensual and thus legitimate, whether the creditor receives full satisfaction on its claim or not.[355] That is why a plan need not provide payment in full to "all, or substantially all" creditors impacted by a non-debtor release, as mandated by the *Master Mortgage* test.[356] Instead, only dissenting creditors must be paid in full. As a practical matter, however, it is likely that creditors subject to a third-party release would demand equal treatment and object to any plan of reorganization that paid only some of them in full, dooming the release under Element Three—creditor consent. Therefore, plans with non-debtor releases satisfying Element Four will generally provide payment in full on *all* extinguished claims.[357]

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that the substituted *in rem* rights against the debtor's property are the equivalent of the extinguished *in personam* rights."). While Professor Brubaker is addressing non-debtor releases *generally* in each of these quotes, only *actual* releases have the redistributional effects that he finds objectionable. *See also* Boyle, *supra* note 27, at 446 ("Courts that place the debtor's survival above that of the creditor's right to full payment [by granting an actual release] ignore the implicit mandate of the Code's absolute priority rule that the creditor's right to full payment is superior to creating value for shareholders.").

353 *See* Brubaker, *supra* note 27, at 1029 (asserting that the policies underlying nonbankruptcy law are undermined by non-debtor releases that extract value "involuntarily from those creditors with valuable non-debtor claims"); *see also* Boyle, *supra* note 27, at 440–44 (concluding that non-debtor releases subvert the policies protected by joint and several liability and guaranty law).

354 11 U.S.C. § 1129(a)(7) (2000).

355 This assumes that the release meets the requirements for consensual releases. For a fuller discussion of such releases, see *supra* Part I.B.

356 *See In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994).

357 While jurisdictional issues are generally beyond the scope of this Article, *see supra* note 38, one important question regarding the procedure for granting a third-party release deserves brief attention. To the extent bankruptcy courts possess subject matter jurisdiction over actions between non-debtors, they do so pursuant to their "related to" jurisdiction. *See* 28 U.S.C. § 1334(b) (2000) (providing that federal district courts have jurisdiction "of all civil proceedings arising under title 11, or arising in or *related to* cases under title 11") (emphasis added); § 157(a) (permitting "any or all" bankruptcy matters to be referred to bankruptcy courts); Celotex Corp. v. Edwards, 514 U.S. 300, 308 n.5 (1995) ("Proceedings 'related to' the bankruptcy

Releases are Not Mandatory. Finally, while the pro-release courts have adopted multiple standards for assessing the validity of non-debtor releases, they generally agree that a release is not mandatory simply because the accepted test is satisfied. Third parties are not automatically entitled to a release. Instead, when the relevant standard is met, bankruptcy courts *may*, in the exercise of their *discretion*, extinguish claims against third parties.[358] I

include . . . suits between third parties which have an effect on the bankruptcy estate."); 1 COLLIER ON BANKRUPTCY ¶ 3.01[4][c][ii], at 3–24 (Lawrence P. King ed., 15th ed. rev. 2004) ("[C]ivil proceedings encompassed by § 1334(b)'s 'related proceedings' are those whose outcome could conceivably have an effect on the bankruptcy estate and that . . . are suits between third parties . . . ."). For a discussion of the types of third-party actions that satisfy the "related to" standard, see generally *id.* ¶ 3.01[4][c][ii][B].

However, absent consent of the parties, 28 U.S.C. § 157(c)(2) (2000), bankruptcy courts may not issue final judgments in related proceedings, *id.* at § 157(c)(1). Instead, "[i]n such proceedings the bankruptcy judge shall submit proposed findings of fact and conclusions of law to the district court, and any final order or judgment shall be entered by the district judge after considering the bankruptcy judge's proposed findings and conclusions and after reviewing de novo those matters to which any party has timely and specifically objected." *Id.* A non-debtor release is effectively a final judgment. *In re* Digital Impact, Inc., 223 B.R. 1, 12 (Bankr. N.D. Okla. 1998) (holding that a non-debtor release "is equivalent to issuing a final adjudication of the merits" of the released claims); Brubaker, *supra* note 27, at 1070 ("A non-debtor release is not a mere status quo injunction; a non-debtor release effectively adjudicates the released non-debtor action. The release operates as an adjudication on the merits, fully binding for res judicata/preclusion purposes."). Accordingly, any such release issued by the bankruptcy court—whether set forth in a confirmed plan of reorganization or contained in proposed findings and conclusions in a related proceeding—is subject to de novo review by the district court if a party impacted by the release objects on appeal. *See* Brubaker, *supra* note 27, at 1070 ("The non-debtor actions that are 'adjudicated' through non-debtor releases are, at best, non-core, 'related to' actions, beyond the power of a bankruptcy judge to determine by final order without consent of the litigants.").

Alternatively, to avoid the waste of judicial resources resulting from duplicative assessment of a third-party release, the district court can withdraw the reference under 28 U.S.C. § 157(d) and grant the release itself, in the first instance. *See* Brubaker, *supra* note 27, at 1070 n.432 ("Limitations on a bankruptcy court's core jurisdiction are not implicated where the district court enters the final order approving non-debtor release and injunction provisions."). Indeed, that is precisely what happened in *Drexel* and *Robins*. *See* SEC v. Drexel Burnham Lambert, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 130 B.R. 910, 915, 924–28 (S.D.N.Y. 1991) (noting that the reference was withdrawn in a prior order and granting a non-debtor release to the debtor's directors and officers), *aff'd*, 960 F.2d 285 (2d Cir. 1992); Beard v. A.H. Robins Co. (*In re* A.H. Robins Co.), 59 B.R. 99, 105–07 (Bankr. E.D. Va. 1986) (setting forth, in an appendix, a copy of the district court's prior order withdrawing the reference), *aff'd*, 828 F.2d 1029 (4th Cir. 1987); *In re* A.H. Robins Co., 88 B.R. 742, 751–55 (E.D. Va. 1988) (confirming the debtor's plan and expressly approving of the third-party release contained therein), *aff'd*, 880 F.2d 694 (4th Cir. 1989).

358 *See, e.g.*, Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002) ("We hold that when the following seven factors are present, the bankruptcy court *may* enjoin a non-consenting creditor's claims against a non-debtor.") (emphasis added); SEC v. Drexel Burnham Lambert, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 960 F.2d 285, 293 (2d Cir. 1992) ("In bankruptcy cases, a court *may* enjoin a creditor from suing a third party, provided the injunction plays an important part in the debtor's reorganization plan.") (emphasis added); *In re* Optical Tech., Inc., 216 B.R. 989, 994 (M.D. Fla. 1997) ("Under appropriate circumstances, this Court *may* use its power under Section 105 to issue a third-party injunction and release in order to effectuate a reorganization plan.") (emphasis added); *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 937 (W.D. Mo. 1994) ("[T]he Court believes that the exercise of [the] power

agree with the pro-release authorities on this point. Once the four elements of my amended *Master Mortgage* test are complied with, a release is permissible, but not required.[359]

C. *The Anti-Release Position Revisited: Channeling Releases and the Risk of Plan Failure*

As noted in the previous Subpart, this Article contends that bankruptcy courts only possess the authority to grant *channeling*, involuntary, non-debtor releases—releases contained in plans that pay dissenting creditors in full on any extinguished third-party claims. *Actual* releases are prohibited because they violate the best-interests test.[360] As a result, from this point forward, I shall use the terms "non-debtor release," "third-party release," and "channeling release" synonymously.

Channeling releases are not immune from the anti-release arguments discussed in Subpart A. In fact, courts have held that such releases violate § 524(e)[361] and that they are beyond the powers conferred by § 105(a) under the narrow construction of that statute.[362]

[to grant third-party releases] is discretionary."); *In re* Mahoney Hawkes, LLP, 289 B.R. 285, 300 (Bankr. D. Mass. 2002) ("I conclude that injunctive relief protecting non-debtor third parties *may* be appropriate depending upon the circumstances of the case.") (emphasis added); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 685 (Bankr. D.D.C. 1992) ("Under section 105(a) a bankruptcy court *may* enter a permanent injunction enjoining suits against non-debtor parties funding a plan of reorganization if the court find that such an injunction is essential to effectuate the plan of reorganization.") (emphasis added).

359 For an example of a countervailing factor beyond the four elements of the test, see *infra* notes 670–78 and accompanying text.

360 *See supra* notes 348–51 and accompanying text.

361 *See In re* Keller, 157 B.R. 680, 682, 686 (E.D. Wash. 1993) (ruling that § 524(e) barred a channeling release); *see also* Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1402 (9th Cir. 1995) (holding that § 524(e) bars non-debtor releases and expressly rejecting *Robins*); Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 601–02 (10th Cir. 1990) (holding that § 524(e) prohibits any permanent injunction "extended post-confirmation . . . that effectively relieves the nondebtor from its own liability to the creditor"), *modified*, 932 F.2d 898 (10th Cir. 1991); *In re* B.W. Alpha, Inc., 89 B.R. 592, 595–96 (Bankr. N.D. Tex. 1988) (stating, in dicta, that § 524(e) would have barred confirmation of the plan if the non-debtor release had not been removed even though the objecting creditor was receiving payment in full under the plan), *aff'd*, 100 B.R. 831 (N.D. Tex. 1988); Starr, *supra* note 27, at 487, 491–92 (arguing that § 524(e) prohibits all non-debtor releases); Boyle, *supra* note 27, at 422, 436 (same).

362 *See, e.g.*, *In re* Dow Corning Corp., 244 B.R. 721, 742–43 (Bankr. E.D. Mich. 1999) (holding that because § 105(a) must be used in conjunction with other Code provisions and does not permit the creation of new substantive rights, the statute does not give bankruptcy courts the power to issue non-debtor releases (citing Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988), and United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986)) (ruling that the channeling releases contained in the plan could not extinguish the claims of dissenting creditors), *rev'd*, 255 B.R. 445, 480 (E.D. Mich. 2000), *rev'd in part*, *aff'd in pertinent*

Even if § 524(e) does not bar third-party releases and the broad view of § 105(a) (or a similar construction of § 1123(b)(6)) is correct, there is a final anti-release argument that deserves attention. According to this objection, channeling releases are not an appropriate use of the bankruptcy court's equitable powers because they place the risk of plan failure on the releasing creditor rather than the benefiting non-debtor.

To elaborate, plans of reorganization that contain a channeling release typically provide payment in full on a deferred basis to those with claims extinguished by the release. For example, in *In re McCall*, the creditors impacted by the release were to receive their distributions over eight or ten year periods.[363] In *Master Mortgage*, the plan provided that the creditors would be paid over twenty years.[364]

Critically, there is no guarantee that a debtor will comply with its duties under a plan of this type. Instead, a bankruptcy court must find only by a preponderance of the evidence that a plan is "feasible"[365]—that confirmation "is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor."[366] What if the reorganized entity encounters financial difficulties before fulfilling its obligation to the creditors whose non-

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part, 280 F.3d 648, 658 (6th Cir. 2002); *In re* Sybaris Clubs, Int'l, Inc., 189 B.R. 151, 156 (Bankr. N.D. Ill. 1995) (holding that § 105(a) can only be used to carry out other provisions of the Code and thus that the non-debtor releases contained in the debtor's plan were invalid, despite the fact that the sole dissenter would receive payment in full under the plan); *see also In re* Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (deciding that the court did not have sufficient power under § 105(a) to grant a non-debtor release that extinguished the contractual rights of a shareholder that was co-insured with the debtor as part of a settlement between the debtor and the insurance company, even if the settlement provided the shareholder with payment in full; the benefits provided by the settlement "would not be the same thing" as the shareholder's contractual rights under the insurance policy), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992); Meltzer, *supra* note 27, at 26 & n.83 (concluding that a bankruptcy court may not issue a non-debtor release under § 105(a) unless the extinguished claims are paid in full contemporaneously with confirmation of the plan).

363 *In re* McCall, No. 93-00632, 1997 WL 428580, at *3, *16 (Bankr. D.D.C. May 27, 1997).

364 *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 932 (Bankr. W.D. Mo. 1994). For anti-release decisions that fit this pattern, *see Sybaris Clubs*, 189 B.R. at 153 (creditors impacted by the channeling release were scheduled to be paid over "twenty-seven quarters" under the debtor's plan); *Keller*, 157 B.R. at 682, 686 (the debtor's plan of reorganization contained a channeling release and provided that the only creditor affected by the release would receive payment through an annuity); *In re* L.B.G. Props., Inc., 72 B.R. 65, 66–67 (Bankr. S.D. Fla. 1987) (plan provided that a creditor impacted by a provision that appears to be a channeling release would be paid over several years).

365 Danny Thomas Props. II Ltd. P'ship v. Beal Bank, S.S.B. (*In re* Danny Thomas Props. II Ltd. P'ship), 241 F.3d 959, 963 (8th Cir. 2001) ("The debtors bear the burden of establishing the feasibility of their plans by a preponderance of the evidence."); Fin. Sec. Assurance, Inc. v. T-H New Orleans Ltd. P'ship (*In re* T-H New Orleans Ltd. P'ship), 116 F.3d 790, 801 (5th Cir. 1997) (same).

366 11 U.S.C. § 1129(a)(11) (2000). This subparagraph of § 1129(a) is known as the "feasibility requirement." *T-H New Orleans Ltd. P'ship*, 116 F.3d at 801.

debtor claims were extinguished, and ultimately fails to pay these creditors in full? In such circumstances, the third-party release forces the creditors to bear the loss. The release shields the previously liable non-debtors, eliminating the creditors' alternative source of recovery.

This possibility of default under a plan of reorganization is not insignificant. Several studies indicate that a high percentage of debtors do not fully consummate their chapter 11 plans.[367] Indeed, one authoritative source concluded that "only a fraction of confirmed plans are fully performed."[368] In other words, the promise of payment in full over time contained in any plan "is just that—a promise—that may or may not come to pass."[369]

A further element of risk is present in mass tort cases where the injured creditors' rights are not liquidated prior to confirmation. In addition to the danger that the debtor will face unforeseen financial problems after emerging from bankruptcy, the value of the tort claims is unknown, making it more difficult to determine whether the reorganized debtor will be able to meet its plan commitments. For example, substantially more individuals filed personal injury claims in the Johns-Manville bankruptcy than had been anticipated, and their claims were much larger than expected.[370] The litigation trust set up to

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[367] *See, e.g.*, Nancy Rhein Baldiga, *Is This Plan Feasible? An Empirical Legal Analysis of Plan Feasibility*, 101 COM. L.J. 115, 128 (1996) (concluding that even in cases in which the chapter 11 reorganization plan has undergone an extensive feasibility challenge, half of the confirmed, nonliquidating plans failed to fully consummate); Edith S. Hotchkiss, *Postbankruptcy Performance and Management Turnover*, 50 J. FIN. 3, 10, 15 (1995) (empirical study of 197 public companies emerging from chapter 11 as operating entities, finding that over 40% continued to experience operating losses in the following three years, and 32% required further restructuring through a second bankruptcy filing, a private workout or an out-of-court liquidation); Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 608 (1993) (empirical study of large, chapter 11 cases finding that in 32% of those where the entity reached confirmation of a plan, the emerging company subsequently refiled under chapter 11); Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97 COM. L.J. 297, 324–25 (1992) (empirical study of forty-five confirmed chapter 11 plans finding that only 58% completed all payments to creditors under the plan; concluding that only 10% of the chapter 11 cases in the study area resulted in a consummated plan); Edward M. Flynn, Statistical Analysis of Chapter 11, Administrative Office of the United States Courts—Statistical Analysis & Reports Division—Bankruptcy Division 13 (Oct. 1989) (unpublished report) (concluding that between 10 and 12% of chapter 11 cases filed result in a successful reorganization). The language for these parentheticals is borrowed largely from Brubaker, *supra* note 27, 987 n.102, and NAT'L BANKR. REVIEW COMM'N, *supra* note 32, at 610 n.1550.

[368] NAT'L BANKR. REVIEW COMM'N, *supra* note 32, at 610.

[369] Brubaker, *supra* note 27, at 987 n.102.

[370] Findley v. Falise (*In re* Joint E. and S. Dist. Asbestos Lit.), 78 F.3d 764, 769 (2d Cir. 1996) ("*Findley I*"); Findley v. Trustees of the Manville Personal Injury Settlement Trust (*In re* Joint E. and S. Dist. Asbestos Lit.), 237 F. Supp. 2d 297, 303 (E. & S.D.N.Y. 2002) ("*Findley II*").

resolve the personal injury claims thus was forced to reduce payments to 10% of a claim's value,[371] and subsequently dropped awards to 5%.[372]

The risk of plan failure took a slightly different form in the bankruptcy of A.H. Robins. There, after conducting an evidentiary hearing, the district court estimated that $2.475 billion would be sufficient to pay all Dalkon Shield Claimants in full.[373] Pursuant to the plan, roughly this amount was placed in several claims resolution trusts designed to compensate the tort creditors.[374] However, while the money available for the claimants was not contingent on the future financial performance of the reorganized debtor, it was *capped* at $2.475 billion.[375] Thus, if the estimation had turned out to be inaccurate, the trusts could have been exhausted before all Dalkon Shield claims were satisfied.[376] Nonetheless, the A.H. Robins plan was approved by the Fourth Circuit.[377]

Faced with a plan strikingly similar to that of A.H. Robins, the *Dow Corning* bankruptcy court sharply criticized the risk-allocating impact of channeling releases.[378] Directing its attention to the Fourth Circuit's reliance upon marshaling of assets as a justification for the *Robins* release, the bankruptcy judge explained that, under marshaling, the party enjoined cannot be prejudiced.[379] But since Dow Corning's plan places a cap on tort liability, there is a possibility that creditors will be harmed by the channeling release—

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371 *Findley I*, 78 F.3d at 770

372 *Findley II*, 237 F. Supp. at 314.

373 Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 697–700 (4th Cir. 1989).

374 *Id.* at 720–21; Georgene M. Vairo, *The Dalkon Shield Claimants Trust: Paradigm Lost (Or Found)?*, 61 FORDHAM L. REV. 617, 627 (1992).

375 *Menard-Sanford,* 880 F.2d at 697.

376 *Id.*

377 *Id.* at 700–02.

378 Under Dow Corning's plan, several third parties, including the debtor's shareholders, are released from all liability relating to Dow Corning's silicone breast implants. *In re* Dow Corning Corp., 255 B.R. 445, 475 (E.D. Mich. 2000), *rev'd in part*, 280 F.3d 648 (6th Cir. 2002). The plan provides a capped fund of $2.35 billion net present value for tort claimants, including a $400 million litigation facility intended to liquidate contested claims. *In re* Dow Corning Corp., 244 B.R. 721, 727–28 (Bankr. E.D. Mich. 1999), *rev'd*, 255 B.R. 445 (E.D. Mich. 2000), *rev'd in part*, 280 F.3d 648 (6th Cir. 2002). A group of tort claimants challenged the adequacy of the litigation facility, but the bankruptcy court concluded that it was more than sufficient to pay in full the claims of all plaintiffs that did not settle. *Dow Corning Corp.*, 244 B.R. at 729–32. Upon remand from the Sixth Circuit, the District Court agreed, issuing detailed findings on the matter. 287 B.R. 396, 415–16 (E.D. Mich. 2002).

379 *Dow Corning Corp.*, 244 B.R. at 743 (Bankr. E.D. Mich. 1999) (citing *In re* Atlas Commercial Floors, Inc., 125 B.R. 185, 188 (Bankr. E.D. Mich. 1991)); *see also* 53 AM. JUR. 2d *Marshaling Assets* § 14 (1996) ("If a paramount creditor or third party holding a superior lien will be delayed or inconvenienced in the collection of its debt or prejudiced or injured in any manner, the doctrine of marshaling cannot be applied.").

that some will not be paid in full.[380] Even if the risk is low, the court continued, "the *equitable* solution (and marshaling, of course, is grounded in equity) would be to grant only a provisional injunction—one which terminates if and when the 'primary' fund [i.e., the reorganized debtor] is exhausted."[381] Moreover, a marshaling injunction merely compels a senior claimant to exhaust one fund before proceeding against the second; it does not terminate the claimant's right to collect from the second source until it is paid in full.[382] Thus, a channeling release "which permanently bars creditors from seeking compensation from the 'secondary' payment source [i.e., the non-debtor] is neither equitable nor consistent with the objectives of a marshaling injunction."[383]

While the *Dow Corning* bankruptcy court focused on discrediting the Fourth Circuit's use of marshaling, its analysis applies more broadly. In essence, the *Dow Corning* bankruptcy court argued that channeling releases are inequitable because they place the risk of plan failure on the creditors rather than on the non-debtors that receive the release. As one commentator succinctly argued, it "hardly comports with equity" to release tort claims

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380 *Dow Corning Corp.*, 244 B.R. at 743.

381 *Id.*

382 *Id.* (citing C.T. Dev. Corp. v. Barnes (*In re* Oxford Dev. Ltd.), 67 F.3d 683, 687 (8th Cir. 1995)).

383 *Id.* Admittedly, the bankruptcy court was reversed on appeal by the district court, which found that bankruptcy courts have sufficient equitable authority to issue non-debtor releases. *In re* Dow Corning Corp., 255 B.R. 445, 475 (E.D. Mich. 2000), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648 (6th Cir. 2002). And the Sixth Circuit agreed with the district court on this point. 280 F.3d at 656–58. However, neither the district court nor the court of appeals expressly addressed the bankruptcy judge's marshaling argument. *See* 255 B.R. at 475–94; 280 F.3d at 656–61. Moreover, Professor Brubaker was similarly critical of the *Robins* court's use of marshaling. Noting that a marshaling injunction must treat all parties equitably, Brubaker explained that the doctrine cannot be used to "extinguish a creditor's rights against either 'fund' until the creditor's claim is fully satisfied." Brubaker, *supra* note 27, at 1038–39 n.301. This makes marshaling of assets an "inapposite analogy" to non-debtor releases. *Id.* at 1038 n.301.

Professor Brubaker further attacked the relevancy of marshaling of assets by noting that the doctrine only applies to in rem claims and thus does not justify extinguishing the in personam rights generally subject to non-debtor releases. *Id.* at 1039 n.301. Boyle agrees. He observed that marshaling only applies where "*one debtor* has *two funds* from which a particular creditor may draw." Boyle, *supra* note 27, at 433 n.66 (emphasis added). Marshaling does not apply where the creditor has rights against the assets of the debtor *and* a third party and therefore renders no support for non-debtor releases. *Id.*; *see also* 53 AM. JUR. 2d *Marshaling Assets* § 28 (1996) ("[T]he principle of marshaling assets is not applicable to a case where one of the funds is the property of a surety of the common debtor.") (emphasis removed). However, the Fourth Circuit only cited marshaling as a useful analogy; it did not contend that a marshaling injunction perfectly parallels a non-debtor release. Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 701 (4th Cir. 1989). Accordingly, because it is highly technical, the "in rem" limitation is not a significant objection to the Fourth Circuit's reliance on marshaling. But the "prejudice" argument raised by the *Dow Corning* bankruptcy court and Brubaker remains important because it relates to marshaling's equitable nature rather than to a technical aspect of the doctrine.

against third parties, channel the claims to the estate for payment in full, but force the claimholders to "bear the risk that the [estate] . . . is sufficient to compensate them."[384] In contrast, under a provisional injunction, the non-debtors remain liable until the creditors' claims are fully satisfied. The risk of a default thus falls primarily on the non-debtors rather than the creditors because any such default terminates the injunction and permits the creditors to pursue the non-debtors for their deficiencies.[385]

This reasoning is relevant to both mass tort bankruptcies involving unliquidated claims and cases where a plan merely delays payment on liquidated claims until well beyond confirmation. In fact, one court converted a channeling release into a provisional injunction because the creditor impacted by the release was to be paid over seven years.[386] Although the court did not explain its rationale, it seems likely that it was motivated by the possibility of a default years after confirmation.

In sum, according to the last anti-release argument, channeling non-debtor releases, contained in plans where payment in full is deferred or otherwise not guaranteed, unfairly shift the risk of plan failure from the beneficiaries of the release to the creditors whose claims are extinguished. Such releases are therefore inequitable. Pursuant to this objection, bankruptcy courts may, at most, employ the equitable power conferred by §§ 105(a) and 1123(b)(6) to issue provisional injunctions.[387]

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384 Starr, *supra* note 27, at 492; *cf.* Meltzer, *supra* note 27, at 26 n.83, 41 (concluding, on slightly different grounds, that non-debtor releases are permissible only when the creditors are paid in full for their extinguished claims on the effective date of the plan; otherwise, the channeling release improperly prohibits the creditors from recovering from a third party "that could afford to pay [them] immediately").

385 As noted in the taxonomy section, *see supra* note 77, a provisional injunction still places some risk on the creditor. There is no guarantee that the non-debtor will be available to satisfy any deficiency not paid by the debtor when the provisional injunction expires. For example, the non-debtor itself could declare bankruptcy. In the absence of an injunction, the creditor may collect immediately from the non-debtor, eliminating any such risk.

386 *See In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673757, at *8-*11 (Bankr. M.D.N.C. Feb. 24, 2000) (applying the *Master Mortgage* test in holding that the provisional injunction contained in the debtor's plan was permissible under the Code because each of the five factors was satisfied); *see id.* at *11 ("Because VPC will receive full payment of its claim over time, however, the court finds that it is appropriate to condition the injunction on MAC Panel meeting its obligations to VPC under the Modified Plan.").

387 It should be noted that there is also a split in the authorities over whether bankruptcy courts have sufficient power to issue provisional injunctions. For example, in *In re Davis Broad., Inc.*, the court held that § 524(e) prohibits the "release or a post-confirmation stay" of third-party obligations and invalidated the provisional injunction contained in the debtor's plan. *In re* Davis Broad., Inc., 176 B.R. 290, 291–92 (M.D. Ga. 1994). The court explained that a non-debtor's liability is improperly "'affected' regardless of whether it is released or, as in this case, stayed for a long period of time." *Id.* at 292; *see also* Seaport Auto. Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts, Inc.), 113 B.R. 610, 614–16 (B.A.P. 9th

D. Can the Pro- and Anti-Release Decisions Be Reconciled?

As illustrated in the prior three Subparts, the debate over the validity of non-debtor releases appears to be a genuine one. However, some courts and commentators have attempted to harmonize the pro- and anti-release decisions. First, they contend that the cases in the two lines of authority are factually distinct.[388] The pro-release decisions typically involved complex, mass torts

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Cir. 1990) (holding that § 524(e) prohibited a provisional injunction that stayed collection efforts against certain non-debtors for five years after confirmation of the plan); Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 758, 762 (D. Utah 1985) (holding that postconfirmation injunctions staying legal action against a non-debtor are impermissible; invalidating a chapter 11 plan provision that appears to be a provisional injunction). But others disagree, including some courts from anti-release jurisdictions. In *In re Seatco, Inc.* ("*Seatco*"), the plan contained a provisional injunction stating that all creditors of the debtor "shall be temporarily enjoined" under § 105(a) from attempting to collect on their allowed claims against certain third parties related to the debtor. *In re* Seatco, Inc., 257 B.R. 469, 474 (Bankr. N.D. Tex. 2007) The Northern District of Texas bankruptcy judge, who sits within the Fifth Circuit, an anti-release jurisdiction, held that the provisional injunction did not run afoul of § 524(e). *Id.* at 474; *In re* Seatco, Inc. 259 B.R. 279, 284 (Bankr. N.D. Tex. 2001) ("*Seatco II*"). The court reasoned that while the plan temporarily enjoined the objecting secured creditor from foreclosing on its guarantee, the guarantors' liability "is not affected." *Seatco*, 257 B.R. at 475. If the reorganized debtor defaulted on its obligations under the plan, the injunction terminated automatically and the secured creditor would be free to pursue the guarantor for any outstanding amounts owed. *Id.* The court also stated that the provisional injunction did not have to satisfy the *Master Mortgage* factors; only non-debtor releases need to meet that standard. *Seatco II*, 259 B.R. at 284 n.6; *see also* Feld v. Zale Corp. (*In re* Zale), 62 F.3d 746, 761–62 (5th Cir. 1995) (appearing to hold that a bankruptcy court had the power pursuant to § 105(a) to issue a provisional injunction staying a creditor from prosecuting a claim against a non-debtor); *In re* Shaw Aero Devices, Inc., 283 B.R. 349, 351–53 (Bankr. M.D. Fla. 2002) (citing *Master Mortgage* as authority for approving of a non-debtor release, which the court construed to operate as a provisional injunction); *In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673757, at *9 (Bankr. M.D.N.C. Feb. 24, 2000) (concluding that §§ 105(a) and 1123(b)(6) confer upon bankruptcy courts sufficient authority to issue provisional injunctions).

[388] *See In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 937 (W.D. Mo. 1994) (distinguishing (1) Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592 (10th Cir. 1990), *modified*, 932 F.2d 898 (10th Cir. 1991), because the non-debtor there made no contribution, the release was not essential to the reorganization, and the only effected creditor objected, and (2) Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621 (9th Cir. 1989), because the third party in that case made no contribution and the only creditor impacted by the release dissented); Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 985 (1st Cir. 1995) (the bankruptcy court, whose confirmation opinion is attached as an appendix to the First Circuit decision, distinguished *Am. Hardwoods* and *W. Real Estate Fund* because the non-debtors in those cases made no contribution and thus the third-party releases were not essential); *In re* Am. Family Enters., 256 B.R. 377, 407–08 (D.N.J. 2000) (distinguishing *Am. Hardwoods*, *W. Real Estate Fund*, and Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1401 (9th Cir. 1995), because none of the *Master Mortgage* factors were present in those cases); Myerson & Kuhn v. Brunswick Assoc. Ltd. P'ship (*In re* Myerson & Kuhn), 121 B.R. 145, 156–57 (S.D.N.Y. 1990) (distinguish *Am. Hardwoods* because the non-debtors did not propose that they contribute to the debtor's estate in return for the requested injunction); Inman, *supra* note 27, at 641–47 (concluding that "a closer review suggests that the differing outcomes between the [pro-release and anti-release decisions] may be as much a product of different factual settings as a result of divergent interpretations

where all, or most, of the *Master Mortgage* factors were met.[389] The anti-release opinions generally concerned smaller disputes where the release clearly did not satisfy the *Master Mortgage* test.[390] Second, the Ninth Circuit distinguished *Robins* in *American Hardwoods*, a leading anti-release case, explaining that the Fourth Circuit had limited *Robins* to its "unusual facts."[391] Finally, some anti-release opinions contain language suggesting that non-debtor releases are permissible where the extinguished claims are paid in full out of the estate—i.e., where channeling releases are involved[392]—or where other *Masters Mortgage* factors are observed.[393]

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of the law"); Swallow, *supra* note 27, at 720–23 (arguing that the pro- and anti-release cases are factually distinguishable).

[389] For examples of mass tort, pro-release cases see Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 653–54 (6th Cir. 2002) (silicon breast implant mass tort); Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 697 (4th Cir. 1988) (Dalkon Shield mass tort); *In re* Am. Family Enters., 256 B.R. 377, 383, 386–87 (D.N.J. 2000) (mass tort concerning deceptive mailings containing magazine subscription offers); SEC v. Drexel Burnham Lambert Group, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 130 B.R. 910, 913–14 (S.D.N.Y. 1991) (securities violations mass tort), *aff'd*, 960 F.2d 285 (2d Cir. 1992).

[390] Inman, *supra* note 27, at 645–46 ("Few if any of the factors that influence the pro-release decisions were present in key release cases."); *see also* Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 594–95, 598–601 (10th Cir. 1990) (the non-debtors made no contribution, there was no payment full of the creditor's claim against the non-debtor, the only creditor affected by the non-debtor release dissented, and the action did not involve a mass tort), *modified*, 932 F.2d 898 (10th Cir. 1991); Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 622 (9th Cir. 1989) (the non-debtors did not offer to make any contribution to the debtor's plan, the impacted creditors did not overwhelmingly approve of the release, the injunction was not essential to plan, and the case did not involve a mass tort); *In re* Keller, 157 B.R. 680, 681–82 (E.D. Wash. 1993) (small bankruptcy regarding assets and liabilities of less than one million dollars, the non-debtors made no contribution to the plan, and the only creditor impacted by the channeling release objected to the plan).

[391] Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 626 (9th Cir. 1989); *see also* Inman, *supra* note 27, at 646–47 (arguing that because *Am. Hardwoods* distinguished *Robins*, the Ninth Circuit may have "merely concluded that an injunction was unwarranted on those particular facts" before it).

[392] For example, the Fifth Circuit offered the following in *Feld v. Zale Corp.*:

> In [*Drexel* and *Johns-Manville*], the courts upheld permanent injunctions of third-party claims because while the injunction permanently enjoined the lawsuits, it also channeled those claims to allow recovery from separate assets and thereby avoided discharging the nondebtor. . . . The injunction at issue in this case provided no alternative means for [the creditors] to recover from [the non-debtor]. . . . Accordingly, because the permanent injunction as entered improperly discharged a potential debt of . . . a nondebtor, the bankruptcy court exceeded its power under § 105.

Feld v. Zale Corp. (*In re* Zale), 62 F.3d 746, 760–61 (5th Cir. 1995) (citations omitted); *see also* In re Arrowmill Dev. Corp., 211 B.R. 497, 506 (Bankr. D.N.J. 1997) (holding that consensual non-debtor releases are permissible because in that context the creditor "has not been forced by virtue of the discharge provisions of the code, to accept less than full value for its claim"); *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 66–67 (Bankr. W.D. Pa. 1994) (distinguishing Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, However, these attempts at reconciliation are unpersuasive. To begin with, the seminal anti-release cases from the Ninth and Tenth Circuits used unqualified language in ruling that § 524(e) bars non-debtor releases. In *American Hardwoods*, the court held that "[s]ection 524(e) . . . limits the court's equitable power under section 105 to order the discharge of the liabilities of non-debtors."[394] The Tenth Circuit was even clearer in *Western Real Estate Fund*, concluding that § 524(e) prohibits any permanent injunction "extended post-confirmation . . . that effectively relieves the non-debtor from its own liability to the creditor."[395] Such statements leave little room to argue that the anti-release courts would approve of third-party releases in any context. Removing any doubt, the Ninth Circuit reinforced its rejection of *Robins* in a later decision:

> Lowenschuss looks to our discussion, in *dictum* in *American Hardwoods* of the Fourth Circuit's decision in *In re A.H. Robins*, as indicating our approval of the Fourth Circuit's approach. Lowenschuss ignores the clear language of *American Hardwoods*, where we expressly declined to adopt the approach set forth in *In re A.H. Robins*; we stated, in *dictum*, "[e]ven if we adopted *In re A.H. Robins Co.* . . ., it would not dictate a different result."[396]

700–01 (4th Cir. 1989), and MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 90–91 (2d Cir. 1988), because in those cases objecting creditors received one hundred percent payment on their non-debtor claims out of the estate and thus the non-debtor releases "resulted in no detriment to the claimant"); *In re* Boston Harbor Marina Co., 157 B.R. 726, 730 (Bankr. D. Mass. 1993) (holding that actual releases violate § 524(e), but stating in dicta, in reliance upon *Johns-Manville* and *Robins*, that channeling releases in the mass tort context may be permissible); Lewis, *supra* note 27, at 170, 176 (arguing that § 524(e) bars non-debtor releases unless the creditors receive payment in full on any discharged debts); Han, *supra* note 27, at 554, 579 (concluding that non-debtor releases are permissible under § 105(a) only where holders of any released claims are paid in full under the plan); Swallow, *supra* note 27, at 709 (concluding that non-debtor releases are permissible where the plan provides for payment in full on all extinguished claims).

[393] *See, e.g.*, *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 67 (Bankr. W.D. Pa. 1994) (distinguishing *Robins* and *Johns-Manville* because without resolution of the mass tort claims in those cases "a reorganization was not feasible").

[394] Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 626 (9th Cir. 1989).

[395] Landsing Div. Props.-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 601 (10th Cir. 1990).

[396] Resorts Int'l, Inc. v. Lowenschuss (*In re* Lowenschuss), 67 F.3d 1394, 1402 (9th Cir. 1995) (citation omitted) (emphasis removed).

Furthermore, several anti-release decisions struck down channeling releases.[397] And some have even invalidated provisional injunctions.[398] There also are a number of pro-release cases that do not involve mass torts,[399] and others where there was no payment in full on the extinguished claims under the plan of reorganization.[400] Finally, none of the anti-release decisions that distinguished

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[397] *See, e.g.*, *In re* Keller, 157 B.R. 680, 682, 686 (E.D. Wash. 1993) (ruling that § 524(e) barred a channeling release); *In re* Sybaris Clubs, Int'l, Inc., 189 B.R. 152, 156 (Bankr. N.D. Ill. 1995) (holding that § 105(a) can only be used to carry out other provisions of the Code and thus that the non-debtor releases contained in the debtor's plan were invalid, despite the fact that the sole dissenter would receive payment in full under the plan); *see also In re* Forty-Eight Insulations, 133 B.R. 973, 976–79 (Bankr. N.D. Ill. 1991) (deciding that the court did not have sufficient power under § 105(a) to grant a non-debtor release that extinguished the contractual rights of a shareholder that was co-insured with the debtor as part of a settlement between the debtor and the insurance company, even if the settlement provided the shareholder with payment in full; the benefits provided by the settlement "would not be the same thing" as the shareholder's contractual rights under the insurance policy), *aff'd*, 149 B.R. 860 (N.D. Ill. 1992); *In re* B.W. Alpha, Inc., 89 B.R. 592, 595–96 (Bankr. N.D. Tex. 1988) (stating, in dicta, that § 524(e) would have barred confirmation of the plan if the non-debtor release had not been removed even though the objecting creditor was receiving payment in full under the plan), *aff'd*, 100 B.R. 831 (N.D. Tex. 1988); Meltzer, *supra* note 27, at 26 n.83 (concluding that non-debtor releases are not permissible unless the extinguished claims are paid in full contemporaneously with confirmation of the plan); Starr, *supra* note 27, at 487, 491–92 (arguing that § 524(e) prohibits all non-debtor releases); Boyle, *supra* note 27, at 422, 436 (same).

[398] *See, e.g.*, Seaport Automotive Warehouse, Inc. v. Rohnert Park Auto Parts, Inc. (*In re* Rohnert Park Auto Parts, Inc.), 113 B.R. 610, 614–16 (B.A.P. 9th Cir. 1990) (holding that § 524(e) prohibited a provisional injunction that merely stayed collection efforts against non-debtors for five years after confirmation of the plan and did not release the co-debtors from liability); *In re* Davis Broad., Inc., 176 B.R. 290, 291–92 (M.D. Ga. 1994) (§ 524(e) bars a bankruptcy court from "affecting" the liability of a guarantor in any way, including through a provisional injunction staying the creditors' legal actions against certain third parties pending execution of the plan); *see also* Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 758, 762 (D. Utah 1985) (holding that postconfirmation injunctions staying legal action against a non-debtor are impermissible; invalidating a chapter 11 plan provision that appears to be a provisional injunction).

[399] *See, e.g.*, Greer v. Gaston & Snow (*In re* Gaston & Snow), Nos. 93 Civ. 8517 (JGK), 93 Civ. 8628 (JGK), 1996 WL 694421, at *2-*5 (S.D.N.Y. Dec. 4, 1996) (approving of a non-debtor release in the bankruptcy of a law firm); Monarch Life Ins. Co. v. Ropes & Gray (*In re* Monarch Capital Corp.), 173 B.R. 31, 41–43 (D. Mass. 1994) (approving of non-debtor releases in the bankruptcy of an insurance and real estate holding company), *aff'd*, 65 F.3d 973 (1st Cir. 1995); *In re* Transit Group, Inc., 286 B.R. 811, 815 (Bankr. M.D. FL. 2002) (approving of a non-debtor release in the bankruptcy of a trucking company); *see also In re* Mac Panel Co., No. 98-10952C-11G, 2000 WL 33673784, at *8 (Bankr. M.D.N.C. Mar. 8, 2000) ("The recognition of bankruptcy court jurisdiction in the *A.H. Robins* case is not rendered inapplicable in the present case on the grounds that mass tort litigation was involved in the *Robins* case.") (provisional injunction case).

[400] *See, e.g.*, *In re* Am. Family Enters., 256 B.R. 377, 387, 390–92, 405–08 (D.N.J. 2000) (granting several non-debtor releases despite the fact that the creditors impacted by one of the releases were to recover only ninety percent of their extinguished claims under the plan); SEC v. Drexel Burnham Lambert Group, Inc. (*In re* Drexel Burnham Lambert Group, Inc.), 130 B.R. 910, 913–14, 920, 925, 927–28 (S.D.N.Y. 1991) (approving of several non-debtor releases even though the plan of reorganization did not provide for payment in full on all released claims), *aff'd*, 960 F.2d 285 (2d Cir. 1992); Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 302, 305–08 (Bankr. E.D. Pa. 1999) (holding that the court had authority to grant non-debtor releases on behalf of partners that contributed to the debtor-partnership's chapter

the pro-release authorities expressly held that non-debtor releases are permissible where there is payment in full or other *Master Mortgage* factors are satisfied.

Accordingly, I disagree with those judges and commentators that have asserted that the split in the courts is more apparent than real. Instead, this Article argues that, in light of *United States v. Energy Resources Co.*,[401] the pro-release courts simply have the better view. In the next Part, I summarize *Energy Resources*.

IV. *UNITED STATES V. ENERGY RESOURCES CO.*

A. *Internal Revenue Law Background*

A number of Internal Revenue Code ("IRC")[402] sections and Internal Revenue Service ("IRS") rules play an important role in *Energy Resources*. This Subpart sets forth a brief description of these provisions.

1. *Trust Fund Taxes*

The IRC requires employers to withhold money from their employees' paychecks for the purpose of paying the employees' income and social security taxes.[403] These funds are held in trust for the United States[404] and are referred to as "trust fund taxes."[405] Under § 6672 of the IRC, if an employer fails to pay any portion of its trust fund taxes, the government may collect the deficiency directly from the employees responsible for collecting the taxes.[406] These individuals are known as "responsible persons."[407] Critically, the IRS

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11 plan even though the partnership's creditors "probably will not be" paid in full on their extinguished claims); *see also* Myerson & Kuhn v. Brunswick Assoc. Ltd. P'ship (*In re* Myerson & Kuhn), 121 B.R. 145, 150, 156–57 (S.D.N.Y. 1990) (suggesting that a non-debtor release of partners contributing to the debtor-partnership's estate may be permissible even though the creditors would not be paid in full if the contributing partners paid on the basis of their net worth and the substantive validity of any claims against them).

[401] 495 U.S. 545 (1990).

[402] 26 U.S.C. §§ 1-9833 (2000).

[403] §§ 3102(a), 3402(a).

[404] § 7501(a).

[405] Slodov v. United States, 436 U.S. 238, 242–43 (1978).

[406] § 6672.

[407] *Slodov*, 436 U.S. at 245. The liability created by § 6672 is separate and distinct from the employer's. United States v. Prescription Home Health Care, Inc. (*In re* Prescription Home Health Care, Inc.), 316 F.3d 542, 544 (5th Cir. 2002). Nonetheless, it is the IRS's policy to only seek a single recovery for its losses. United States v. Huckabee Auto Co., 783 F.2d 1546, 1548 (11th Cir. 1986); United States v. Chene (*In re*

may not seek reimbursement from responsible persons for *non*trust fund taxes that the employer fails to pay, such as corporate income taxes.[408]

2. *Voluntary Versus Involuntary Payment of Taxes*

IRS procedures generally permit a taxpayer who "voluntarily" makes a tax payment to designate the specific debt to which the funds will be applied.[409] If a taxpayer turns over money to the agency "involuntarily," however, it is denied this privilege. Instead, the agency decides how to allocate the funds.[410] And the IRS almost always applies an involuntary payment to nontrust fund taxes before trust fund taxes if both types are owed.[411] It does so because paying the nonguaranteed liabilities first increases the likelihood that the government will ultimately collect the full amount of taxes due from the taxpayer.[412]

B. In re Energy Resources, Co.

Energy Resources concerned two bankruptcy proceedings that each addressed whether a bankruptcy court may order the IRS to allocate payments made by a chapter 11 debtor to the debtor's trust fund tax liabilities before its nontrust fund tax liabilities.[413] In the first case, the bankruptcy of Energy Resources Co., Inc., the bankruptcy court confirmed a reorganization plan under which all of the debtor's assets, except its environmental division, were

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Chene), 236 B.R. 69, 73 (M.D. Fla. 1999). And while the IRS is not bound to exhaust its remedies against the employer before seeking to collect under § 6672 from the responsible persons, it is also IRS policy to not assess a § 6672 penalty against a responsible person if the employer is in bankruptcy and complying with the terms of its payment plan. *Prescription Home Health Care*, 316 F.2d at 544–45.

408 IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 225 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990).

409 Rev. Proc. 2002-26, 2002-1 C.B. 746, superseding Rev. Rul. 79-284, 1979-2 C.B. 83, modifying Rev. Rul. 73-305, 1973 C.B. 43, superseding Rev. Rul 58-239, 1958 C.B. 94. At the time *Energy Resources* was decided, the controlling authority was Rev. Rul 79-284. United States v. Energy Res. Co., 495 U.S. 545, 548 (1990). Rev. Proc. 2002-26 does not contain any substantive changes relevant to this Article.

410 *See* IRS Policy Statement P-5-60(7) (1993), *reprinted in* 1 INTERNAL REVENUE MANUAL—ADMINISTRATION § 1.2.1.5.14 (CCH Rev. 2000) ("The taxpayer, of course, has no right of designation [between trust fund and non-trust fund taxes] of payments resulting from enforced collection measures."); 1 INTERNAL REVENUE MANUAL—ADMINISTRATION § 5.9.15.2(2) (CCH Rev. 2006) (noting that "[p]ayments received through the bankruptcy proceeding are considered *involuntary payments*" and that such payments are allocated to the debtor's various tax liabilities according to IRS policy).

411 *Energy Res.*, 871 F.2d at 227 (collecting authorities).

412 *Id.* at 231.

413 United States v. Energy Resources Co., 495 U.S. 545, 547–48 (1990).

placed in a liquidating trust for the purpose of paying the company's debts.[414] Energy Resources owed the IRS about one million dollars in federal taxes, most of which constituted trust fund taxes.[415] The plan provided that the IRS would receive full compensation on its claims, including interest, via a series of payments made by the trust.[416]

Fourteen months after the plan was confirmed, the trustee of the liquidating trust made a payment to the IRS and requested that the agency apply the funds to the debtor's trust fund tax liabilities.[417] After the IRS refused, the trustee asked the bankruptcy court to order the agency to allocate all plan payments as directed by the trustee.[418] The trustee contended that it needed this authority to maximize the benefit to the estate of any tax payments.[419] The trustee further argued that designating payments to trust fund taxes before nontrust fund taxes (1) would not harm the IRS since the reorganization plan provided that the agency would receive payment in full on its claims, and (2) was necessary to implement a settlement with Richard Rosen, a former officer of Energy Resources.[420] Under the terms of the settlement, Rosen agreed to immediately pay $14,000 to the trust and, in return, the trustee agreed that the debtor's payments to the IRS would be used to extinguish trust fund tax liabilities first.[421] The tax allocation was intended to limit the personal liability of Energy Resources's officers, providing them with an additional incentive to cooperate with the trustee during the reorganization.[422]

Finally, the trustee asserted that payments made to the IRS under a chapter 11 plan are "voluntary" and therefore a debtor-payee is entitled to designate the liabilities to which the funds are applied.[423] The IRS focused on this last point in its response, maintaining that tax payments made under a plan of reorganization are "involuntary."[424] The bankruptcy court thus only considered "whether . . . tax payments made pursuant to a confirmed chapter

[414] *In re* Energy Res. Co., 59 B.R. 702, 703 (Bankr. D. Mass. 1986), *aff'd*, No. 1987 WL 42960 (D. Mass. Aug. 5, 1987), *aff'd*, 871 F.2d 223 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990).

[415] IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 226 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990).

[416] *Energy Res.*, 59 B.R. at 703.

[417] *Energy Res.*, 871 F.2d at 227.

[418] *Energy Res.*, 59 B.R. at 704.

[419] *Id.*

[420] *Id.*

[421] *Id.*

[422] *Id.*

[423] *Id.*

[424] *Id.*

11 plan of reorganization are voluntary or involuntary."[425] The court ruled that such payments are voluntary and accordingly the trustee "had every right to direct the IRS to allocate the payments to the trust fund portion of the taxes owed."[426] The district court affirmed in a short unpublished opinion that also simply addressed the voluntary-versus-involuntary issue.[427]

C. In re Newport Offshore, Ltd.

In the second case, the bankruptcy of Newport Offshore, Ltd. ("Newport"), Allied Marine Associates agreed to (1) pay all of Newport's prepetition tax debts, which included trust fund tax and nontrust fund tax liabilities, (2) pay various other debts, and (3) invest additional money in the company.[428] In return, Allied Marine would receive an eighty-five percent equity share in the reorganized debtor.[429] Based upon this agreement, a plan of reorganization was formulated under which Newport would pay all of its tax debts over approximately six years.[430] The plan also provided that payments to the IRS would be allocated to extinguish trust fund tax liabilities first.[431]

The IRS objected to the designation provision.[432] In particular, the agency contended that allowing debtors to designate payments to trust fund tax liabilities unfairly benefits responsible individuals and shifts the risk of nonpayment of taxes to the government.[433] The bankruptcy court disagreed, explaining that the IRS had no factual support for its assertion that the designation was intended to benefit a responsible person.[434] The agency also maintained that the plan was likely to fail once the trust fund tax liabilities

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425 *Id.*

426 *Id.* at 706. The precise reasoning adopted by the court in reaching this conclusion is not relevant for purposes of this Article.

427 *See* United States v. Energy Res. Co. (*In re* Energy Res. Co.), Civ. A. No. 86-1533 Mc., 1987 WL 42960, at *1 (D. Mass. Aug. 5, 1987), *aff'd*, 871 F.2d 223 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990).

428 IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 226 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990).

429 *Id.*

430 *Id.* The Bankruptcy Code previously required that tax debts be paid within six years of the date of assessment. *Compare* 11 U.S.C. § 1129(a)(9)(C) (2000) *with* 11 U.S.C. § 1129(a)(9)(C) (1988). That section now mandates payment of priority tax claims within five years of the date the debtor files for bankruptcy. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 710, 119 Stat. 127 (amending § 1129(a)(9)(C)).

431 *Energy Res.*, 871 F.2d at 226.

432 *In re* Newport Offshore, Ltd., 75 B.R. 919, 920–23 (Bankr. D.R.I. 1987), *subsequently aff'd*, 871 F.2d 223 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990).

433 *Id.* at 923.

434 *Id.*

were paid, relieving the responsible individual of any obligations but denying the government full compensation on its claims.[435] The bankruptcy court again thought otherwise, noting that a plan of reorganization likely to fail in the manner described by the IRS "would not be confirmable under 11 U.S.C. § 1129(a)(11)," the plan feasibility requirement.[436] Therefore, the court overruled the IRS's objection.[437]

On appeal, the district court reversed,[438] reasoning that Congress "'did not ever intend that a principal stockholder of a corporation in a reorganization would have the ability to negotiate in the Bankruptcy Court an exculpatory provision with respect to trust fund taxes.'"[439]

D. Consolidated Appeals Before the First Circuit

Energy Resources and *Newport Offshore* were consolidated before the First Circuit. The court of appeals made two rulings. First, it decided that the IRS may "call tax payments within a chapter 11 reorganization 'involuntary,' for purposes of applying its own regulations."[440] Second, it held that a bankruptcy court may order the IRS to allocate "'involuntary' payments to a taxpayer's 'trust fund' liability first, provided that the court reasonably concludes that this allocation will likely increase the reorganization plan's chances for success."[441] Only the latter ruling is relevant here.

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[435] *Id.*

[436] *Id.* A plan may be confirmed only if it is "not likely to be followed by the liquidation, or need for further financial reorganization, of the debtor . . . ." 11 U.S.C. § 1129(a)(11) (2000).

[437] *Newport Offshore*, 75 B.R. at 922–23.

[438] IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 226 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990); Brief for the United States ("Petitioner's Brief") at 7, 1989 WL 428936, United States v. Energy Res. Co, Inc., 495 U.S. 545 (1990) (No. 89-255). The district court did not issue a written opinion; it ruled from the bench. Petitioner's Brief at 7.

[439] Petitioner's Brief, *supra* note 438, at 8 (apparently quoting a transcript of the district court's ruling from the bench).

[440] *Energy Res.*, 871 F.2d at 227. The IRS asserted that payments under a chapter 11 plan are "involuntary" because they are made pursuant to a court order confirming the plan. *Id.* at 228. The debtors countered that payments are "involuntary" only where they are compelled by a levy, execution, or judicial sale and the more limited role of the bankruptcy court in confirming a plan of reorganization falls short of this standard. *Id.*

[441] *Id.* at 227. The First Circuit adopted the following test for bankruptcy court's to use in making this determination:

> [U]pon consideration of the reorganization plan as a whole, in so far as the particular structure or allocation of payments increases the risk that the IRS may not collect the total tax debt, is that risk nonetheless justified by an offsetting increased likelihood of rehabilitations, *i.e.*, increased likelihood of payment to creditors who might otherwise lose their money.

Beginning with the source of the authority to issue tax allocation orders, the court of appeals explained that "Congress has granted bankruptcy courts broad equitable powers, including those powers 'expressly or by necessary implication conferred by Congress.'"[442] As support for this proposition, the First Circuit cited § 105(a).[443] The court then observed that an order designating tax payments to trust fund tax debts would satisfy the "appropriate" requirement of that statute in at least some circumstances.[444] For example, responsible persons might agree to contribute funds to their employer's estate in bankruptcy that are necessary for a successful reorganization, but only if they receive assurances from the court that the reorganized debtor will pay its trust fund taxes first.[445]

The court then considered whether any laws prohibit a bankruptcy court from using its equitable power to dictate the allocation of tax payments. It found none.[446] Specifically, the First Circuit explained that no provision in the Bankruptcy Code limits a bankruptcy court's authority to designate tax payments.[447] It also concluded that there is no policy "embodied in any specific [nonbankruptcy] statute, tax or otherwise, that either directly, or by

Id. at 234. When this standard is satisfied, bankruptcy courts may order an allocation. *Id.*

[442] *Id.* at 230 (quoting Johnson v. First Nat'l. Bank of Montevideo, 719 F.2d 270, 273 (8th Cir. 1983)).

[443] *Id.* (citing 11 U.S.C. § 105(a) (2000)).

[444] *Energy Res.*, 871 F.2d at 230. In addition to § 105(a), the First Circuit observed that "bankruptcy courts have long had the legal power to tell creditors against which of a debtor's several debts they are to apply a particular payment." *Id.* at 231 (citing National Bank of the Commonwealth v. Mechanics' National Bank, 94 U.S. 437, 439 (1876)). But the court's focus appeared to be on § 105(a). *See id.* at 230–32.

[445] *Id.* The First Circuit explained as follows:

> Suppose . . . that certain third parties that included "responsible" individuals were willing to advance enough money to rehabilitate the corporation only if the court would assure them that the reorganized corporation would pay its "trust fund" tax debts first. That assurance would diminish the likelihood that the third parties would have to pay debts personally; without it they might prefer immediate liquidation, which could mean total payment on all tax debt, and a "guarantee that no tax penalty will be assessed against them personally." . . . Of course, to give the "responsible" persons this assurance, and then allow the reorganized corporation to stretch out its tax payments over six years, might diminish the chances that the reorganizing firm will pay its *entire* tax debt, for no one can be absolutely certain that the reorganized corporation will still have money four or five years in the future. But, by giving this assurance, and thereby keeping the firm alive, the bankruptcy court would also increase the chances that the debtor will pay something to its general unsecured creditors.

Id. The First Circuit also noted that frequently "'the efforts put forth by these officers during the reorganization is the corporation's only hope for future viability.'" *Id.* at 230–31 (quoting United States v. A&B Heating & Air Conditioning, Inc. (*In re* A&B Heating & Air Conditioning), 823 F.2d 462, 465 (11th Cir. 1987)).

[446] *Id.* at 231–33.

[447] *Id.* at 231.

manifesting a congressional intent, circumscribes a bankruptcy court's general powers in the respect at issue here."[448] In reaching this conclusion, the First Circuit expressly disagreed with the government's contention that tax allocation orders frustrate the purpose of § 6672, the statute that allows the IRS to collect trust fund taxes from responsible individuals.[449] The court conceded that § 6672 manifests a strong congressional policy in favor of collecting *trust fund taxes*.[450] But the IRS's chapter 11 allocation policy did not assure the prompt payment of those taxes; instead, the policy only guaranteed that trust fund taxes are paid last, after all *nontrust fund tax* debts are extinguished. In essence,

> [t]he IRS seeks to use the personal liability of "responsible" persons, not to help collect "trust fund" tax debts, but to collect *total* tax debts. And, in order to help maximize that total collection, it is willing, by not crediting the "trust fund" debts first, to run a greater risk of *not* collecting the "trust fund" debt at all. . . . [This] effectively forces the 'responsible' persons to be liable for the *last* tax dollars due from the debtor, a liability which Congress did not say "responsible" persons ought to have.[451]

The First Circuit admitted that "because money is fungible, the effect of [an allocation order] is to diminish the IRS's ability . . . to obtain" full recovery on all tax liabilities (for both trust fund and nontrust fund taxes),[452] and to assist the responsible individuals.[453] But, it responded, "we can find no policy in any statute suggesting that Congress felt that bankruptcy courts must maximize the likelihood that the IRS will receive its entire tax debt, irrespective of all other goals, particularly the Bankruptcy Court's preference for rehabilitation over liquidation."[454] In sum, there is "no *statute* that attaches so overriding an importance to" total tax collection "as to circumscribe a [bankruptcy] court's

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448 *Id.* at 232.
449 *Id.*
450 *Id.*
451 *Id.*
452 *Id.* at 233.
453 *Id.* at 225. The First Circuit offered the following illustration to demonstrate the point:

> If, for example, the reorganized corporation were to run out of money a few years from now and "trust fund" debts were still owed, the government might collect them from "responsible" individuals. But if all "trust fund" debts have been paid, and if the only debts are for, say, ordinary corporate income taxes, the government will be out of luck, for there are no *personal* guarantors of payment of a corporation's tax liabilities.

Id.
454 *Id.* at 233.

statutorily granted powers to the contrary" in § 105(a).[455] And the IRS cannot otherwise limit a bankruptcy judge's statutory authority "by using an internal rule" like those governing allocation of involuntary tax payments.[456]

Turning to the pending cases, the First Circuit held that the allocation provision in Newport's chapter 11 plan was permissible because (1) the bankruptcy court found that the designation would do more than merely benefit the responsible individuals, and (2) Allied Marine Associates would not have made its financial contribution to Newport, an investment necessary for the success of the reorganization, without the provision.[457] The court reached the same conclusion with respect to *Energy Resources* because the bankruptcy court (1) heard argument regarding the trustee's claims that the designation would not damage the IRS and was necessary to the estate, and (2) found that the chapter 11 plan was made possible by the infusion of capital from the responsible individual.[458]

E. Proceedings Before the United States Supreme Court

1. Briefs of the United States

The government presented two arguments in its appeal to the Supreme Court. First, it contended that tax payments made pursuant to a chapter 11 plan of reorganization are involuntary.[459] Second, the United States asserted that bankruptcy courts may not order the IRS to allocate involuntary payments to trust fund tax liabilities.[460] Once again, the discussion here will focus only on the latter point.

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455 *Id.* at 232.

456 *Id.* In addition, the First Circuit offered a policy argument in support of its holding. It explained that "it makes administrative sense for the bankruptcy court to have the power to determine, in some cases, the debt allocation of Chapter 11 tax payments." *Id.* at 231. That is because bankruptcy courts have more expertise than the IRS at balancing "the increased 'tax collection' risk against the increased likelihood of 'rehabilitation'" that results from allocation. *Id.*

Finally, the First Circuit also observed that because of the Tax Anti-Injunction Act, 26 U.S.C. § 7421, nothing, including any allocation order, restrains the IRS from pursuing a responsible person before the trust fund tax debt is satisfied by the debtor itself. *Id.* at 233 (collecting authorities). Section 7421 provides, with certain exceptions, that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed." 26 U.S.C. § 7421(a) (2000).

457 *Energy Res. Co.*, 871 F.2d at 234.

458 *Id.*

459 Petitioner's Brief, *supra* note 438, at 16–25; Reply Brief for the United States ("Reply Brief") at 3–6, 1990 WL 505638, United States v. Energy Res. Co., 495 U.S. 545 (1990) (No. 89-255).

460 Petitioner's Brief, *supra* note 438, at 25–38; Reply Brief, *supra* note 459, at 10–17.

The government began by emphasizing that nothing in the Bankruptcy Code explicitly grants bankruptcy courts the authority to apply chapter 11 tax payments to trust fund tax debts first.[461] The United States then conducted a lengthy analysis of § 105(a). Arguing for the narrow view of that statute, the government stated that § 105(a) does not give bankruptcy courts boundless authority to enter any order that facilitates a reorganization.[462] Instead, the statute "speaks to the procedural powers of the bankruptcy court."[463] Accordingly, § 105(a) only permits bankruptcy courts to enter orders that implement specific provisions of the Code.[464] Section 105(a) "'does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity.'"[465] These conclusions, the government asserted, are consistent with the Supreme Court's oft-quoted statement in *Norwest Bank Worthington v. Ahlers* that "'whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.'"[466]

Based upon the above, the government asserted that an order is not "necessary or appropriate" under § 105(a) simply because it might improve the debtor's chances for a successful reorganization.[467] Rehabilitation, while the central goal of chapter 11, may be pursued "only within the limitations established by the Code that address other, often competing, interests."[468] And a critical countervailing value reflected in the Bankruptcy Code is the government's interest in collecting delinquent taxes.[469] Congress sought to protect this interest through §§ 507(a)(8), 523(a)(1)(A), and 1129(a)(9)(C), where it, respectively, granted priority status to specified tax claims, made those claims nondischargeable in the bankruptcy of an individual, and required that chapter 11 debtors satisfy all such liabilities within six years of the date of assessment.[470] When a bankruptcy court commands the IRS to designate

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461 Petitioner's Brief, *supra* note 438, at 28.

462 *Id.* at 29.

463 *Id.*

464 *Id.* at 29–30 (citing United States v. Sutton, 786 F.2d 1305, 1307 (5th Cir. 1986), and Bird v. Carl's Grocery Co. (*In re* NWFX, Inc.), 864 F.2d 593, 595 (8th Cir. 1989)); Reply Brief, *supra* note 459, at 12.

465 Petitioner's Brief, *supra* note 438, at 30 (quoting *Sutton*, 786 F.2d at 1308).

466 *Id.* (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)).

467 *Id.* at 31.

468 *Id.*

469 *Id.*

470 Petitioner's Brief, *supra* note 438, at 32; Reply Brief, *supra* note 459, at 14. Section 507(a)(8) grants priority status to certain tax claims. Section 523(a)(1)(A) makes those debts nondischargeable in the bankruptcy of an individual. And § 1129(a)(9)(C) *required* that a chapter 11 plan of reorganization provide

payments to trust fund tax liabilities first to facilitate a reorganization, the court upsets the Code's careful balancing of the interests in rehabilitation and collection of taxes, defeating the congressional policy judgments reflected in §§ 507(a)(8), 523(a)(1)(A), and 1129(a)(9)(C).[471] Allocation orders have this effect because, as the First Circuit explained,[472] such orders shift the risk of plan failure from the responsible persons, "whose misconduct created the trust fund tax delinquency in the first place," to the IRS.[473]

The government acknowledged that numerous provisions in the Code limit its right to recover outstanding taxes.[474] For example, not all tax claims are afforded priority status,[475] penalties on federal tax claims are subordinated to general unsecured claims,[476] and the IRS can be forced to return payments that constitute preferential transfers.[477] But the United States contended that these mandates simply offer further evidence of the deliberate balance struck in the Code between tax collection and other competing interests, a balance disrupted by the allocation orders at issue.[478]

In sum, a § 105(a) designation grants relief to the debtor and responsible persons that is beyond the scope of any other Code section.[479] Because such an order does not implement a specific bankruptcy statute, as required by the narrow view of § 105(a), it is invalid.[480] Allocation orders are also impermissible because they violate §§ 507(a)(8), 523(a)(1)(A), and 1129(a)(9)(C).[481]

The government further contended that allocation orders are not authorized by § 105(a) because they "substantially undermine congressional policies embodied in" § 6672 of the IRC.[482] In essence, the government argued that

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for the payment of priority tax claims within six years of the date of assessment. *See supra* note 430 for a discussion of a recent amendment to this statute.

471 Petitioner's Brief, *supra* note 438, at 32–33.

472 *See supra* note 453 and accompanying text.

473 Reply Brief, *supra* note 459, at 14. The impact on general unsecured creditors of the IRS's designation policy, on the other hand, is, at most, "the indirect and speculative one that it may dampen the enthusiasm of the debtor's officers in assisting the debtor's rehabilitation." *Id.* at 10–11.

474 Reply Brief, *supra* note 459, at 13.

475 11 U.S.C. § 507(a)(8) (2000).

476 § 726(a)(2), (4).

477 § 547(b).

478 Reply Brief, *supra* note 459, at 13.

479 *Id.* at 12.

480 *Id.*

481 Petitioner's Brief, *supra* note 438, at 32–33; Reply Brief, *supra* note 459, at 14.

482 Petitioner's Brief, *supra* note 438 at 34 (citing 26 U.S.C. § 6672 (2000)).

§ 6672 was designed to protect the IRS's ability to collect *taxes in general* by creating an additional source from which *trust fund taxes* could be obtained.[483] The IRS's method of allocation obviously facilitates this broad policy because "it is in the government's fiscal interests to apply a partial payment to the non-trust fund liability—thereby preserving the alternate source of collection for the trust fund portion of the liability in the event the corporation cannot make full payment."[484]

The government admitted that designating chapter 11 payments to trust fund tax debts first would actually improve the chances that the IRS would collect on *those* liabilities; it would eliminate trust fund tax delinquencies on the IRS's books more quickly than if the payments were applied to other tax debts:[485]

> But the revenue protection policy of Section 6672 is not designed to achieve an accounting goal of assuring that tax dollars collected will be placed in the trust fund column, rather than the non-trust fund column. Rather, the statute is intended to protect the Treasury from a loss—by providing an alternate source of collection from the persons responsible for misusing the funds held in trust for the government.[486]

An allocation order undermines these goals because it "shift[s] the risk of failure of the plan from the responsible officers, whose improper conduct created the trust fund delinquency, to the government."[487] If "the reorganization is not successful and the corporate tax liability is not paid in full, the government could not resort to the responsible persons to make itself whole, but would have to bear the loss of the priority taxes that the corporate debtor did not pay."[488] Permitting the chapter 11 debtor to designate the tax liability extinguished by its payments thus "greatly" diminishes § 6672's deterrent effect on managers.[489] Such orders provide an incentive for responsible individuals to raid trust funds and escape individual liability for unpaid taxes through bankruptcy proceedings.[490]

483 *Id.* at 23, 34.
484 *Id.* at 19.
485 *Id.* at 37.
486 *Id.*
487 *Id.* at 23–24.
488 *Id.* at 24.
489 *Id.* at 34.
490 *Id.*

2. *Respondents' Brief*

Most of the arguments offered in response by the Energy Resources trustee and Newport ("Respondents") are unimportant to the validity of non-debtor releases. However, several points raised in their brief are worth noting.

First, the Respondents argued that allocating tax payments does *not* require "the creation of new substantive rights nor the violation of the provisions and polices expressed in the Code."[491] Instead, the authority to allocate is well within the scope of a bankruptcy court's power under § 105(a) because it is "but an adjunct to the exercise of power under several provision [sic] of the Code which address the treatment of tax claims."[492] "A court order concerning the proper allocation of tax payments is a logical carrying out of" § 507(a), which provides for the priority payment of tax claims,[493] § 1129(a)(9)(C), which mandates that tax claims must be paid within six years of assessment,[494] and § 505, which grants bankruptcy courts the power to determine a debtor's tax liability.[495] In other words, the Respondents asserted that a tax allocation order is permissible even if the narrow view of § 105(a) is controlling.

Alternatively, the Respondents maintained that bankruptcy courts are not limited to issuing orders that are "necessary to implement the clear substantive provisions enacted by Congress."[496] Advocating for the broad interpretation of § 105(a), the Respondents explained that bankruptcy courts have traditionally exercised various types of equitable powers that are not located within the strict four corners of the Code, such as marshaling of assets and voiding state court judgments obtained by fraud.[497] Designation of tax payments is consistent with this authority,[498] particularly in light of the Code's express limitations on the recovery of taxes.[499]

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[491] Joint Brief for the Respondents ("Respondents' Brief") at 27, 1990 WL 505637, United States v. Energy Res. Co., 495 U.S. 545 (1990) (No. 89-255).

[492] *Id*.

[493] *Id.*; 11 U.S.C. § 507(a) (2000).

[494] § 1129(a)(9)(C). See *supra* note 430 for a discussion of a recent amendment to this statute.

[495] § 505; Respondents' Brief, *supra* note 491, at 27.

[496] Respondents' Brief, *supra* note 491, at 27.

[497] *Id.* at 28.

[498] *Id.* at 27–30.

[499] *Id.* at 31–35 (citing, *inter alia*, § 507(a)(7) (indicating that not all federal tax claims are given priority status), § 726(a)(4) (providing that penalties on federal tax claims are subordinated to general unsecured claims), § 547(b) (requiring that the government return preferential transfers)).

The Respondents also argued that allocating tax payments does not conflict with any congressional policy reflected in the Bankruptcy Code or the IRC.[500] They acknowledged that the IRS has a strong interest in collecting trust fund taxes, but countered that "[t]here is nothing in the court of appeals opinion, nor anything else in the law, that removes § 6672 as an alternative source of collection . . . as long as there are trust fund taxes owed."[501] The Respondents explained that "the IRS is not concerned about collection of trust fund taxes, but collection of taxes in total."[502] However, the purpose of § 6672 is to provide for the collection of *trust fund* taxes, not *all* taxes.[503] In effect, "[t]he IRS is attempting to use § 6672 to render the 'responsible person' a guarantor of a debtor's entire tax obligation."[504]

Finally, the Respondents asserted that the government has no basis to complain that the recovery of nontrust fund taxes is subjected to the risk of plan failure by a designation order.[505] Section 1129(a)(9)(C), which allows the debtor to pay its federal taxes through a reorganization plan within six years of assessment,[506] clearly permits the imposition of such risk.[507] The only protection against plan failure that the IRS is entitled to is that provided by the Code's requirement that reorganization plans be feasible.[508]

3. *Opinion of the Supreme Court*

The Supreme Court affirmed the First Circuit, holding that "whether or not the payments at issue are rightfully considered to be involuntary, a bankruptcy court has the authority to order the IRS to apply the payments to trust fund liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan."[509] The Court began its analysis by acknowledging that "[t]he Bankruptcy Code does not explicitly authorize the bankruptcy courts to approve reorganization plans designating tax payments as

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500 *Id.* at 37–40.
501 *Id.* at 37–38.
502 *Id.* at 38.
503 *Id.* at 30.
504 *Id.* at 39.
505 *Id.* at 38.
506 11 U.S.C. § 1129(a)(9)(C) (2000). See *supra* note 430 for a discussion of a recent amendment to this statute.
507 Respondents' Brief, *supra* note 491, at 38.
508 *Id.* at 38 n.16 (citing § 1129(a)(11)).
509 United States v. Energy Res. Co, 495 U.S. 545, 548–49 (1990). The Court affirmed by a vote of 8-1, with Justice White delivering the opinion of the Court. *Id.* at 546. Justice Blackmun dissented, but he did so without comment. *Id.* at 546, 551. There were no concurring opinions. *Id.*

either trust fund or nontrust fund."[510] The Court explained, however, that the Code

> grants the bankruptcy courts residual authority to approve reorganization plans including "any . . . appropriate provision not inconsistent with the applicable provisions of this title." 11 U.S.C. § 1123(b)(5) [now 1123(b)(6)]; *see also* § 1129. The Code also states that bankruptcy courts may "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code. § 105(a). These statutory directives are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.[511]

Having concluded that §§ 105(a) and 1123(b)(6) provide bankruptcy courts with sufficient power to issue tax allocation orders, the Court proceeded to address the IRS's contention that such orders are inconsistent with §§ 507(a)(7), 523(a)(1)(A), and 1129(a)(9)(C) of the Code.[512] The Court rejected the government's argument, explaining that "[i]t is evident that these [statutes] . . . do not preclude the court from issuing orders of the type at issue here" because they "do not address the bankruptcy court's ability to designate whether tax payments are to be applied to trust fund or nontrust fund liabilities."[513] The High Court conceded that if the IRS applies payments to nontrust fund taxes first, collection of all outstanding taxes is more likely because the guaranteed portion would be extinguished last.[514] But, the Court ruled, such a payment plan constitutes

> an added protection not specified in the Code itself: Whereas the Code gives [the Government] the right to be assured that its taxes will be paid in six years, the Government wants an assurance that its taxes will be paid even if the reorganization fails—*i.e.*, even if the bankruptcy court is incorrect in its judgment that the reorganization plan will succeed.[515]

Although an allocation order may be consistent with the Bankruptcy Code, the Supreme Court continued, "[It] might be inappropriate if it conflicted with

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510 *Id.* at 549.

511 *Id.* At the time *Energy Resources* was decided, § 1123(b)(6) was contained at 11 U.S.C. § 1123(b)(5) (1988).

512 *Id.* at 549–50.

513 *Id.* at 550.

514 *Id.*

515 *Id.*

another law that should have been taken into consideration in the exercise of the [bankruptcy] court's discretion."[516] The Court thus turned to the government's § 6672 argument. It started by acknowledging that § 6672 provides the IRS with an alternative source for the collection of trust fund taxes.[517] But designation orders do not interfere with the government's rights because they do not bar the IRS from pursuing responsible persons for the recovery of trust fund tax debts.[518] "[T]o the contrary," the Supreme Court explained, "the orders require the Government to collect trust fund payments before collecting non-trust-fund payments."[519] As for the United States' contention that "if the IRS cannot designate a debtor corporation's tax payment" the debtor might only pay the guaranteed liability, "leaving the Government at risk for non-trust-fund taxes,"[520] the Court had a simple response: "§ 6672, by its terms, does not protect against this eventuality. That section plainly does not require us to hold that the orders at issue here, otherwise wholly consistent with the bankruptcy court's authority under the Bankruptcy Code, were nonetheless improvident."[521]

V. *ENERGY RESOURCES* AND NON-DEBTOR RELEASES

Energy Resources is the Supreme Court's most definitive guidance on the scope of the equitable powers conferred by §§ 105(a) and 1123(b)(6) and the relationship of these statutes to other sections of the Code.[522] Nonetheless, the vast majority of pro-release and anti-release authorities have overlooked the decision.[523] Moreover, those that cited *Energy Resources* did not conduct a

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516 *Id.*
517 *Id.*
518 *Id.*
519 *Id.*
520 *Id.* at 551.
521 *Id.*
522 The Supreme Court has cited § 105(a) just five times. And only in *Energy Resources* did the Court offer any analysis regarding the scope of a bankruptcy court's powers under the statute. *Compare Energy Res.*, 495 U.S. at 549–51, *with* Celotex Corp. v. Edwards, 514 U.S. 300, 301–14 (1995) (considering whether a bankruptcy court had *subject matter jurisdiction* to issue a § 105(a) injunction under § 1334(b), but not addressing the scope of a bankruptcy court's *power* under § 105(a)); Taylor v. Freeland & Kronz, 503 U.S. 638, 645–46 (1992) (refusing to address a party's § 105(a) argument because the party raised the issue for the first time in its opening brief on the merits, thus waiving the issue); Johnson v. Home State Bank, 501 U.S. 78, 88 (1991) (quoting § 105(a) in passing but conducting no analysis of the statute); Northern Pipeline Constr. Co. v. Marathon Pipeline Co., 458 U.S. 50, 55, 85 (1982) (same). Additionally, the Court has only cited § 1123(b)(6) once—in *Energy Resources*.
523 Only a handful of pro-release and anti-release decisions and articles even cited *Energy Resources*, and most are identified in the next footnote.

sustained analysis of the case and failed to comprehend the full impact of its holding.[524] In this Part, I contend that *Energy Resources* resolves the split in the courts concerning the propriety of non-debtor releases by providing compelling support for the pro-release position.

First, *Energy Resources* endorsed the broad view of §§ 105(a) and 1123(b)(6)—the view held by pro-release courts and commentators. The decision illustrates that bankruptcy courts may employ their equitable powers for the general purpose of facilitating a reorganization. In other words, bankruptcy courts possess substantive equitable powers; they are not limited to issuing orders that are tethered to specific sections of the Code.

Second, *Energy Resources* demonstrates that shifting the risk of plan failure from non-debtors to creditors—the exact impact of a channeling release vis-à-vis a provisional injunction—comports with equity where such action is necessary to the success of a reorganization. This defeats a critical objection to channeling non-debtor releases—that such relief is inequitable.

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[524] *See In re* Dow Corning Corp., 255 B.R. 445, 478–79 (E.D. Mich. 2000) (holding that bankruptcy courts have the authority to issue non-debtor releases under §§ 105(a) and 1123(b)(6) because, *inter alia*, those statutes, pursuant to *Energy Resources*, "provide the bankruptcy courts with broad authority to approve plans of reorganization that include provisions affecting creditors' rights to recover against non-debtors, if the provisions are necessary to carry out the plan") (citing *Energy Res.*, 495 U.S. at 549) (offering no additional analysis regarding *Energy Resources*), *rev'd in part*, *aff'd in pertinent part*, 280 F.3d 648 (6th Cir. 2002); Feldstein, *supra* note 27, at 39–40 (arguing that *Energy Resources* provides that §§ 105(a) and 1123(b)(6) grant substantive powers and thus that these statutes confer the authority to issue third-party releases, but merely quoting several sentences from *Energy Resources* before reaching this conclusion) (citing *Energy Res.*, 495 U.S. at 549); Buschman, *supra* note 27, at 942 (concluding that the pro-release decisions are "consistent with the Supreme Court's recent observation regarding the bankruptcy court's 'broad authority to modify creditor-debtor relationships,'" but providing no further discussion) (quoting *Energy Res.*, 495 U.S. at 549). Several other courts cited *Energy Resources* generally before approving of third-party releases. *See, e.g.*, Greer v. Gaston & Snow (*In re* Gaston & Snow), Nos. 93 Civ. 8517 (JGK), 93 Civ. 8628 (JGK), 1996 WL 694421, at *2-*5 (S.D.N.Y. Dec. 4, 1996) (quoting the statement in *Energy Res.*, 545 U.S. at 549, that bankruptcy courts have "broad authority to modify creditor-debtor relationships" in a general discussion of § 105(a) before holding that non-debtor releases are permissible under *Drexel*); Official Comm. of Unsecured Creditors v. Bechtle (*In re* Labrum & Doak), 237 B.R. 275, 305 (Bankr. E.D. Pa. 1999) (quoting the same excerpt from *Energy Resources* in discussing § 105(a) prior to ruling that § 105(a) grants courts the power to issue non-debtor releases); *In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 685–87 (Bankr. D.D.C. 1992) (same); *see also* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 656–57 (6th Cir. 2002) (citing the same quotation from *Energy Resources* in a general discussion of § 105(a) before concluding that bankruptcy courts may grant non-debtor releases by using § 105(a) in conjunction with § 1123(b)(6)). The only anti-release authority to consider *Energy Resources* is Professor Brubaker. And his primary discussion of the case is limited to a single footnote where he argues that *Energy Resources* does not support the conclusion that bankruptcy courts may use their equitable powers in a manner that directly contravenes nonbankruptcy law. *See* Brubaker, *supra* note 27, at 1030 n.255; *see also infra* Part V.C. (addressing whether § 105(a) may be used to issue orders that conflict with nonbankruptcy law).

Third, *Energy Resources* establishes that the Supreme Court's "plain-meaning" approach to statutory interpretation applies when considering whether a § 105(a) or § 1123(b)(6) order conflicts with another provision of the Code. Thus, because § 524(e) fails, by its precise terms, to proscribe or even address non-debtor releases, the statute places no limit upon a bankruptcy court's equitable power to grant that type of relief.

In sum, the *Energy Resources* Court effectively sided with the pro-release authorities on each of the critical issues regarding the validity of third-party releases.[525] These disputes must therefore be resolved in favor of the pro-release position.

Energy Resources does suggest a new objection to non-debtor releases generally ignored by anti-release courts and commentators—that §§ 105(a) and 1123(b)(6) orders may not contravene nonbankruptcy law. But the opinion also provides the dispositive response to that objection. And, as a result, this Article concludes that non-debtor releases are valid under the Bankruptcy Code.[526]

A. Energy Resources *and §§ 105(a) and 1123(b)(6)*

1. The Substantive Equitable Power of Bankruptcy Courts

Pro- and anti-release authorities are divided over the scope of a bankruptcy court's equitable powers. In nearly every pro-release decision, the court implicitly adopted the broad view of § 105(a), finding that the statute, standing alone, confers sufficient power to issue non-debtor releases.[527] Other pro-release authorities concluded that § 1123(b)(6), by itself, permits bankruptcy judges to extinguish claims against non-debtors.[528] In contrast, several anti-release courts and commentators endorsed the narrow view of § 105(a). Pursuant to that interpretation, the statute may only be used to implement other, specific provisions in the Code; it is not a substantive source of power.[529] Therefore, according to the anti-release decisions, because no Code

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525 *See supra* Parts III.A, III.B, and III.C.

526 Of course, non-debtor releases are only valid if they satisfy the four elements of the modified *Master Mortgage* test proposed in Part III.B.4. *See supra* notes 322–57 and accompanying text.

527 *See supra* note 275 and accompanying text.

528 *See supra* note 276 and accompanying text.

529 *See supra* notes 125–34 and accompanying text.

provision can serve as a pathway to grant third-party releases, § 105(a) may not be used to order that type of relief.[530]

Energy Resources ends this debate. There, the Supreme Court embraced the broad view of § 105(a) and an identical construction of § 1123(b)(6). Explaining that these statutes "are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships,"[531] the Court made it clear that both §§ 105(a) and 1123(b)(6) are sources of substantive power: the High Court ruled that bankruptcy judges may use these laws to grant relief for the broad aim of promoting a reorganization; § 105(a) and § 1123(b)(6) orders need not be tethered to more specific Code provisions.

To elaborate, *Energy Resources* held that the equitable statutes may be employed to command the IRS to apply chapter 11 payments to a debtor's trust fund tax liabilities before its nontrust fund tax debts.[532] And the Supreme Court ruled that bankruptcy judges may use §§ 105(a) and 1123(b)(6) to grant such relief for the general goal of facilitating a reorganization. The Court stated that "a bankruptcy court has the authority to order the IRS to apply . . . payments to trust fund liabilities if the bankruptcy court determines that this designation is *necessary to the success of a reorganization plan*."[533] The Court

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530 *See supra* notes 205–13 and accompanying text. One would presume that the anti-release authorities would reach the same conclusion with respect to § 1123(b)(6).

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

532 *Id.*

533 *Id.* at 549 (emphasis added); *accord id.* at 546 ("In this case, we decide that a bankruptcy court has the authority to order the Internal Revenue Service (IRS) to treat tax payments made by Chapter 11 debtor corporations as trust fund payments where the bankruptcy court determines that this designation is necessary for the success of a reorganization plan.").

It should also be noted that the standard adopted by the Supreme Court for determining when bankruptcy courts may exercise their equitable powers is identical to the one set forth in the second element of the modified *Master Mortgage* test. The *Energy Resources* Court held that bankruptcy courts may employ §§ 105(a) and 1123(b)(6) where "*necessary* to the success of a reorganization." *Id.* at 549 (emphasis added). Similarly, under both the original and modified versions of the *Master Mortgage* test, a non-debtor release must be "*essential* to the reorganization." *See supra* notes 326–38 and accompanying text (my amended version of the test); *supra* notes 291–92 and accompanying text (the original test).

Furthermore, while the Supreme Court did not discuss what the term "necessary" means, the First Circuit concluded that the tax designations in the Energy Resources and Newport bankruptcies were necessary because they induced third parties to make substantial contributions to the debtors' estates, making the reorganization plans workable. IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 234 (1st Cir. 1989), *aff'd*, 495 U.S. 545 (1990); *see generally In re* Classic Chemical and Supply Co., 198 B.R. 112, 114 (E.D. Penn. 1996) (using the test proffered by the First Circuit in *Energy Resources* for determining when a court should issue a tax allocation order as "guidance" in construing the Supreme Court's opinion); Bryan T. Camp, *Avoiding the Ex Post Facto Slippery Slope of* Deer Park, 3 AM. BANKR. INST. L. REV. 329, 336 (1995) gave no indication that §§ 105(a) and 1123(b)(6) confer powers that may be employed only in conjunction with other, specific provisions of the Code.[534] In fact, the Supreme Court emphasized that the "Bankruptcy Code does not explicitly authorize" tax allocation orders.[535]

Energy Resources thus demonstrates that bankruptcy courts possess *substantive* equitable powers. Bankruptcy judges may issue orders that are *not tethered* to any particular provision in the Code. Orders that merely implement general bankruptcy policies, such as the promotion of reorganizations, are permissible. In short, *Energy Resources* constitutes a full endorsement of the broad view of §§ 105(a) and 1123(b)(6), the view defended by pro-release authorities.

Tellingly, the *Energy Resources* Court adopted the expansive understanding of the equitable statutes even though it was presented with an opportunity to affirm the First Circuit under the alternative construction. Newport and the Energy Resources trustee contended that bankruptcy courts have the power to designate tax payments even if the narrow view of § 105(a) is correct. They proposed that an allocation order issued pursuant to that law is merely "an adjunct to the exercise of power under several provision [sic] of the Code which address the treatment of tax claims," including §§ 505, 507(a), and 1129(a)(7).[536] But the Supreme Court ignored this suggestion, instead focusing solely on § 1123(b)(6), which it cited sua sponte, and § 105(a).[537]

Perhaps more importantly, the Supreme Court rejected the narrow view of §§ 105(a) and 1123(b)(6) even though the government presented the same

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(observing that some courts have "imputed" the First Circuit's test to the Supreme Court). Once again, the parallel to the pro-release position is clear: facilitating critical contributions to the estate from non-debtors is a key justification for third-party releases. *See supra* notes 291–92, 330, and accompanying text.

534 *Energy Res.*, 495 U.S. at 549–51.

535 *Id.* at 549.

536 Respondents' Brief, *supra* note 491, at 27.

537 495 U.S. at 449; *see also* IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 230 (1st Cir. 1989) (bankruptcy courts may act pursuant to § 105(a) to "promote the 'twofold' (and often conflicting) purpose [sic] of the Bankruptcy Code: ensure fair payment to creditors *and* provide the bankrupt firm with an opportunity to make a 'fresh start'"), *aff'd*, 495 U.S. 545 (1990). Interestingly, § 1123(b)(6) was not cited in any of the briefs or the lower court opinions. The Supreme Court raised this statute on its own.

It should also be noted that the Supreme Court's opinion firmly establishes that § 105(a), by itself, permits the issuance of orders necessary to the success of a reorganization: the allocation order in the Energy Resources bankruptcy was entered fourteen months *after* confirmation of the plan. 871 F.2d at 227. Section 1123(b)(6) thus could not have provided authority for that order because the statute only governs the contents of a plan of reorganization. 11 U.S.C. § 1123(b)(6) (2000) (permitting a plan to "include any other appropriate provision not inconsistent with the applicable provisions of this title").

rationale for adopting a restrictive interpretation that anti-release authorities have proffered—the High Court's statement in *Ahlers* that a bankruptcy court must exercise its equitable powers "within the confines of the Bankruptcy Code."[538] The *Energy Resources* Court apparently did not consider *Ahlers* to be a serious impediment to its holding; *Ahlers* is not cited once in the opinion.[539]

Although the *Energy Resources* Court ignored *Ahlers*, it is not difficult to harmonize the two decisions. *Ahlers* is best understood as reflecting the rule that a bankruptcy court may not use §§ 105(a) and 1123(b)(6) to issue orders that are *inconsistent* with the Code. Courts have, in fact, cited *Ahlers* for this very point,[540] including some anti-release authorities.[541] Thus, *Ahlers* and *Energy Resources* should be reconciled in the following manner: *Energy Resources* establishes that bankruptcy courts have substantive equitable power under §§ 105(a) and 1123(b)(6), while *Ahlers* confirms that any use of this authority must be consistent with the other provisions of the Bankruptcy Code.

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538 *Compare* Petitioner's Brief, *supra* note 438, at 30 (quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)), *with* the authorities discussed *supra* at notes 127, 205–10, and accompanying text.

539 *Energy Res.*, 495 U.S. at 546–51.

540 *See, e.g.*, Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1311 (1st Cir. 1993) (explaining that "the bankruptcy court has no equitable power to deprive creditors of rights or remedies available to them under the Code" because of the language in *Ahlers* that a bankruptcy court may only exercise its equitable power "'within the confines of the Code'") (quoting *Ahlers*, 485 U.S. at 206); United States v. Sanford (*In re* Sanford), 979 F.2d 1511, 1513–14 (11th Cir. 1992) (holding that a bankruptcy court may not use the equitable power under § 105(a) to alter the procedures governing the allowance of claims, *see* § 502(b)(1), because of the same language at *Ahlers*, 485 U.S. at 206); Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture), 995 F.2d 1274, 1283 (5th Cir. 1992) (holding that general equitable principles may not be used to deviate from the requirements of the absolute priority rule, § 1129(b)(2)(B), because of the same language at *Ahlers*, 485 U.S. at 206); *see also* 2 COLLIER ON BANKRUPTCY ¶ 105.01, at 105-7 & n.7 (Lawrence P. King ed., 15th ed. rev. 2004) (citing *Ahlers*, 485 U.S. at 206, for the proposition that "[s]ection 105 does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code"); *In re* Transit Group, Inc., 286 B.R. 811, 815 (Bankr. M.D. Fla. 2002) ("As a general rule, however, the equitable powers of bankruptcy courts must be exercised within the confines of the Bankruptcy Code. Thus, § 105(a) cannot be used to authorize any relief that is prohibited by another provision of the Code.") (no citation to *Ahlers*).

541 *See In re* Sybaris Clubs, Int'l, Inc., 189 B.R. 152, 156 (Bankr. N.D. Ill. 1995) ("More importantly, 'section 105 does not authorize relief inconsistent with more specific law.' This is because 'whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.'") (citations omitted); *In re* Mkt. Square Inn, Inc., 163 B.R. 64, 66–67 (Bankr. W.D. Pa. 1994) (quoting *Ahlers*, 485 U.S. at 206, in support of its conclusion that § 105(a) may not be used to trump § 524(e)'s explicit prohibition on non-debtor releases). Some pro-release courts have cited *Ahlers*, apparently concluding that it presented no bar to third-party releases. *See, e.g.*, LTV Corp. v. Aetna Cas. & Sur. Co. (*In re* Chateaugay Corp.), 167 B.R. 776, 780 (S.D.N.Y. 1994) (holding that bankruptcy courts may issue non-debtor releases under § 105(a) and citing *Ahlers*, 485 U.S. at 206).

Indeed, at least one court has interpreted the two cases in precisely this manner.[542]

Alternatively, *Ahlers* might be understood as providing that §§ 105(a) and 1123(b)(6) may be used only to carry out *bankruptcy* policies—i.e., policies falling "within the confines of the Bankruptcy Code."[543] This interpretation is consistent with the Supreme Court's previous statement that "[t]he Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization."[544] In other words, the *Ahlers* Court may only have been reaffirming the principle that §§ 105(a) and 1123(b)(6) do not constitute "roving commission[s] to do equity."[545] Once again, this construction of *Ahlers* is wholly consistent with *Energy Resources*'s endorsement of the broad view of §§ 105(a) and 1123(b)(6).

Admittedly, some courts have found that *Energy Resources* does not support the broad view of the equitable statutes. The Third Circuit, for example, has argued that "[t]here is nothing in *Energy Resources* which would derogate from our prior observations that § 105 does not give the court the power to create substantive rights that would otherwise be unavailable under the Code."[546] Therefore, any use of § 105(a) must still be tethered to a more

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542 *See* Gurney v. Arizona Dept. Rev. (*In re* Gurney), 192 B.R. 529, 537 (B.A.P. 9th Cir. 1996) (observing that *Energy Res.*, 495 U.S. at 549, explained that bankruptcy courts have broad equitable power under § 105(a), but citing *Ahlers*, 485 U.S. 199, for the proposition that this authority "may be exercised only in a manner not inconsistent with the provisions of the Code"); *see also In re* ATD Corp., 278 B.R. 758, 764 n.3 (Bankr. N.D. Ohio 2002) (citing *Ahlers*, 485 U.S. at 207 for the proposition that a bankruptcy court "cannot use its equity powers to enter an order inconsistent with the Bankruptcy Code," and concluding that *Energy Res.*, 495 U.S. at 549, is in agreement with this point), *aff'd*, 352 F.3d 1062 (6th Cir. 2003). For example, *Energy Resources* does not permit a bankruptcy court to "change the classifications of debts from one category, where full payment is required, to another category where less than full payment is required." Bates v. United States (*In re* Bates), 974 F.2d 1234, 1235–36 (10th Cir. 1992); *accord* United States v. Haas (*In re* Haas), 162 F.3d 1087, 1089–90 (11th Cir. 1998) (holding that *Energy Resources* does not justify an order altering federal tax debts from unsecured priority to secured status, particularly where this has the effect of reducing the IRS's recovery under the plan of reorganization); *In re* Burgess, 171 B.R. 227, 230 (Bankr. E.D. Tex. 1994) ("*Energy Resources* does not encompass a situation where a debtor wishes to reapportion certain tax liability from secured to unsecured in order to discharge a larger portion of the liability.").

543 Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988).

544 NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984).

545 United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986).

546 United States v. Pepperman, 976 F.2d 123, 131 (3d Cir. 1992) (internal quotation marks omitted); *accord* IRS v. Kaplan (*In re* Kaplan), 104 F.3d 589, 597 (3d Cir. 1997) (quoting the language in the text from *Pepperman*, 976 F.2d at 131).

specific Code provision.[547] And the Third Circuit continues to cite *Ahlers* in support of this understanding.[548] But tax allocation orders like those approved of in *Energy Resources* do not implement other statutes of the Code; the orders flow from §§ 105(a) and 1123(b)(6) standing alone. Therefore, the Third Circuit's belief—that the narrow view of the bankruptcy court's equitable authority survives *Energy Resources*—is mistaken.[549]

In sum, *Energy Resources* establishes that the broad view of §§ 105(a) and 1123(b)(6) is the correct interpretation. Bankruptcy courts may use these statutes to issue orders in furtherance of general bankruptcy policies.

2. *The Scope of a Bankruptcy Court's Substantive Equitable Powers After* Energy Resources

Despite *Energy Resources*'s endorsement of the broad view, one might assert that the substantive authority conferred by §§ 105(a) and 1123(b)(6) is not wide enough to permit third-party releases.

Some courts have stated, for example, that bankruptcy judges are prohibited from using their equitable power to provide relief that is not available under *nonbankruptcy* law.[550] In other words, while bankruptcy

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547 *See* Gillman v. Cont'l. Airlines (*In re* Cont'l. Airlines), 203 F.3d 203, 211 (3d Cir. 2000) ("Section 105(a) of the Bankruptcy Code supplements courts' specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code.").

548 *Id.* ("However, section 105(a) has a limited scope. It does not 'create substantive rights that would otherwise be unavailable under the Bankruptcy Code.'") (quoting *Pepperman*, 976 F.2d at 131) (immediately thereafter quoting Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988)).

549 The Third Circuit's confusion is not atypical. For example, the court in Eddy v. Nat'l Union Fire Ins. Co. (*In re* Medical Asset Mgmt., Inc.), 249 B.R. 659, 664 (Bankr. E.D. Pa. 2000), stated that the "scope of § 105(a) is limited in that it only supplements powers specifically enumerated in the Bankruptcy Code" and that the statute does not permit bankruptcy courts to "create substantive rights that otherwise are unavailable under the Bankruptcy Code." *Id*. This is a classic statement of the narrow view of § 105(a). But in the very next paragraph, the *Eddy* court explained that bankruptcy courts may "direct allocation of tax payments" where "necessary to effectuate a successful reorganization or for some other similar purpose," *id*., a conclusion compatible only with the broad view since tax designation orders are not provided for anywhere in the Code. For examples of other post-*Energy Resources* decisions embracing the narrow view, see *supra* notes 126–29, 205, and 210.

550 *See, e.g.*, Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1311 (1st Cir. 1993) ("Because section 105(a) is not a source of substantive rights, the bankruptcy court's order was legitimate only to the extent that some other provision of the Code *or other applicable law* entitled the estate to receive the disputed funds.") (emphasis added); Stratton v. Mariner Health Care, Inc. (*In re* Mariner Post-Acute Network), 329 B.R. 481, 490 (Bankr. D. Del. 2005) ("Section 105(a) cannot create substantive rights that do not otherwise exist under the Bankruptcy Code *or other applicable law*.") (emphasis added); Harold & Williams Dev. Co. v. Crestar Bank (*In re* Harold & Williams Dev. Co.), 163 B.R. 77, 80 (Bankr. E.D. Va.

courts may employ §§ 105(a) and 1123(b)(6) to issue orders that do not implement a specific section of the Code, such "untethered" orders may only grant relief that is allowable under other federal or state law. Thus, to illustrate, bankruptcy judges may marshal assets,[551] a generally available nonbankruptcy remedy,[552] and order substantive consolidation,[553] which is similar in effect to piercing the corporate veil.[554] But nothing outside the Bankruptcy Code sanctions the involuntarily release of a creditor's claim.[555] As a result, this objection concludes, non-debtor releases are beyond the bankruptcy court's equitable power.

Energy Resources defeats this argument. There, the Supreme Court held that bankruptcy courts may issue tax designation orders "whether or not the

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1994) ("[T]he exercise of § 105(a) power should be used to achieve ends provided for by the Code itself *or otherwise by law*.") (emphasis added).

551 *See* Me. Assoc. v. United States (*In re* Morahan), 53 B.R. 489, 492 (D. Me. 1985); *In re* Corso Stein Enters., Inc., 79 B.R. 584, 586–87 (Bankr. D.N.J. 1987); 2 COLLIER ON BANKRUPTCY ¶ 105.04[3] (Lawrence P. King ed., 15th ed. rev. 2004).

552 *See generally* 53 AM. JUR. 2d *Marshaling Assets* §§ 1-59 (1996).

553 2 COLLIER ¶ 105.04[2] ("Substantive consolidation is the merging of the assets and claims of two or more estates.").

554 *See In re* Bonham, 229 F.3d 750, 764 (9th Cir. 2000) ("Substantive consolidation 'enabl[es] a bankruptcy court to disregard separate corporate entities, to pierce their corporate veils in the usual metaphor, in order to reach assets for the satisfaction of debts of a related corporation.'") (quoting James Talcott, Inc. v. Wharton (*In re* Vending Machine Corp.), 517 F.2d 997, 1000 (2d Cir. 1975)). *But see In re* Cooper, 147 B.R. 678, 684 (Bankr. D.N.J. 1992) ("Substantive consolidation is more extensive relief than piercing the corporate veil, because substantive consolidation is a complete merger of legal entities, while piercing the corporate veil is essentially a limited merger for the benefit of only one creditor or group of creditors.").

For other examples, see Resolution Trust Corp. v. Allied Stores Corp. (*In re* Federated Dept. Stores, Inc.), 133 B.R. 886, 888–89, 891–92 (Bankr. S.D. Ohio 1991) (using § 105(a) to alter the dividend and voting rights of preferred shareholders of the debtor's stock and explaining that "the controlling state law very clearly allows the requested relief from the Bankruptcy Court"); *Harold & Williams Dev. Co.*, 163 B.R. at 78, 80–81 (using § 105(a) to compel a bank to disgorge the proceeds of a bankruptcy sale of real property that the conducting officer should, under state law, have paid to a municipality to satisfy tax liens with priority over the bank's deed of trust).

555 *See* Goss Graphics Sys., Inc. v. DEV Industries, Inc., 267 F.3d 624, 627 (7th Cir. 2001) ("Federal courts . . . have no authority to force a settlement.") (collecting authorities). Actually, as Professor Brubaker points out, there is one context in which a court may impose a release on a non-consenting party—when the party is a member of a mandatory, non-opt-out class, certified under Federal Rule of Civil Procedure 23(b)(1)(B). *See* Brubaker, *supra* note 27, at 975 ("Indeed, the only nonbankruptcy context in which a court can impose a settlement upon a nonconsenting claimant is through a court-approved settlement of a mandatory, non-opt-out class action . . . ."); *id.* at 979 ("With respect to the kinds of money damage claims discharged via non-debtor releases, a mandatory class action is available only if the defendant is considered a 'limited fund' because the total of the class members' individual claims may exceed a defendant's resources.") (internal quotation marks omitted). But, Professor Brubaker correctly observes, "Non-debtor releases . . . permit a court to impose a mandatory class settlement of non-debtor actions in circumstances where a mandatory class is impermissible under nonbankruptcy law." *Id.* at 973.

payments at issue are rightfully considered to be *involuntary*."[556] As noted previously, however, under IRS rules, "involuntary" payments are subject to allocation by the government,[557] a position universally endorsed by the courts.[558] Tax allocation orders thus constitute a permissible remedy in bankruptcy that is unavailable to taxpayers under nonbankruptcy law.[559] Accordingly, lack of availability outside bankruptcy is no objection to an order issued pursuant to § 105(a) or § 1123(b)(6).

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[556] United States v. Energy Res. Co., 495 U.S. 545, 548–49 (1990) (emphasis added).

[557] *See* IRS Policy Statement P-5-60(7) (1993), *reprinted in* 1 INTERNAL REVENUE MANUAL—ADMINISTRATION § 1.2.1.5.14 (CCH Rev. 2000) ("The taxpayer, of course, has no right of designation [between trust fund and non-trust fund taxes] of payments resulting from enforced collection measures."); 1 INTERNAL REVENUE MANUAL—ADMINISTRATION § 5.9.15.2(2) (CCH Rev. 2006) (noting that "[p]ayments received through the bankruptcy proceeding are considered involuntary payments" and that such payments are allocated to the debtor's various tax liabilities according to IRS policy).

[558] 60 AM. JUR. 2d *Payment* § 69 (2003) ("[W]hen a payment is involuntary, IRS policy is to allocate the payments as it sees fit, and this rule has been uniformly followed by the courts in the interest of orderly administration. A court will not direct the application of funds in any particular manner in such cases.") (footnotes omitted); *id.* ("Payments made by a taxpayer involved in a bankruptcy proceeding have been held to be involuntary."); *see also* Harker v. United States (*In re* Harker), 357 F.3d 846, 849 (8th Cir. 2004) ("The IRS may apply involuntary payments to whichever liability of the taxpayer it chooses."); *Tull v. United States*, 69 F.3d 394, 397 (9th Cir. 1995) (same) (case involving the trust fund tax penalty under 26 U.S.C. § 6672 (2000)); Fullmer v. United States (*In re* Fullmer), 962 F.2d 1463, 1468 (10th Cir. 1992) ("A taxpayer cannot direct the application of involuntary payments . . . .") (holding that "payments made to the IRS pursuant to a Chapter 11 proceeding" are involuntary), *abrogated on other grounds*, Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15 (2000); United States v. Pepperman, 976 F.2d 123, 127 (3d Cir. 1992) ("Most courts that have considered the issue have concluded that payments made in the bankruptcy context are involuntary.") (case involving the trust fund tax penalty under 26 U.S.C. § 6672 (2000)); DuCharmes & Co. v. State of Michigan, 852 F.2d 194, 196 (6th Cir. 1988) ("When the payment is considered 'involuntary,' however, the IRS makes the allocation, applying the money first to non-trust fund taxes.") (further holding that payments made by a chapter 11 debtor are involuntary).

[559] While court orders allocating involuntary tax payments are not *available* under nonbankruptcy law, such orders do not actually *conflict* with nonbankruptcy law because the IRS rules that tax designation orders override lack the force of law. *See* Fargo v. Comm'r, 447 F.3d 706, 713 (9th Cir. 2006) ("The Internal Revenue Manual does not have the force of law and does not confer rights on taxpayers. This view is shared among many of our sister circuits."); Marks v. Comm'r, 947 F.2d 983, 985 n.1 (D.C. Cir. 1991) ("It is well-settled . . . that the provisions of the [Internal Revenue Manual] . . . are not codified regulations, and clearly do not have the force and effect of law."); United States v. Horne, 714 F.2d 206, 207 (1st Cir. 1983) (same); Hyler v. Comm'r, No. 11023-01L, 2002 WL 31890047 (U.S. Tax. Ct. Dec. 30, 2002) ("Policy statements in the Internal Revenue Manual do not confer enforceable rights on taxpayers."); *see also* Energy Res. Co. v. IRS (*In re* Energy Res. Co.), 871 F.2d 223, 232 (1st Cir. 1989) ("As a general matter, the IRS cannot, in any obvious way, circumscribe, by using an internal rule, a court's statutory powers."), *aff'd*, 495 U.S. 545 (1990). And, as the Supreme Court pointed out in *Energy Resources*, nothing in the Internal Revenue Code barred the tax allocation orders at issue in that case. *Energy Res.,* 495 U.S. at 551; *see also* Brubaker, *supra* note 27, at 1030 n.255 ("Nothing in the Internal Revenue Code . . . prevented prior application of reorganization plan payments [in *Energy Resources*] toward trust fund taxes. Therefore, the bankruptcy court's equitable order did not present a direct conflict between the reorganization policy and the non-debtors liability under the Internal Revenue Code."). The IRS rules at issue are set forth in note 557, *supra*.

Another "scope" objection is that the exercise of equitable power approved of in *Energy Resources* is narrower than a non-debtor release. Tax allocation orders do not extinguish the liability of a third party. Indeed, the *Energy Resources* Court expressly noted that the tax designations in dispute did not prohibit the IRS from pursuing responsible persons for the recovery of trust fund taxes.[560] They merely forced the government to apply payments made by the debtor to trust fund taxes first. However, third-party releases eliminate the obligations of non-debtors. Thus, according to this response, while *Energy Resources* supports the broad view of §§ 105(a) and 1123(b)(6), it does not sanction an interpretation of those laws under which bankruptcy courts have sufficient power to issue non-debtor releases.

This argument is unpersuasive for three reasons. First, there is a fundamental reason why the courts in the bankruptcies of Energy Resources and Newport did not attempt to enjoin the IRS's tax collection efforts, even temporarily: the Tax Anti-Injunction Act explicitly prohibits such an order. That law provides, with a few minor exceptions, that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed."[561] Courts have almost uniformly concluded that this statute prohibits a bankruptcy court from using its equitable power to enjoin the IRS's pursuit of responsible persons for trust fund taxes.[562] And some expressly found that *Energy Resources* does not provide otherwise.[563]

[560] United States v. Energy Res. Co., 495 U.S. 545, 550–51 (1990).

[561] 26 U.S.C. § 7421(a) (2000).

[562] *See, e.g.*, LaSalle Rolling Mills, Inc. v. United States (*In re* LaSalle Rolling Mills, Inc.), 832 F.2d 390, 392–94 (7th Cir. 1987) (Tax Anti-Injunction Act bars a bankruptcy court from using its powers under 11 U.S.C. § 105(a) (2000) to prevent the IRS from collecting trust fund taxes from a responsible person); A to Z Welding & Mfg. Co. v. United States, 803 F.2d 932, 933 (8th Cir. 1986) (§ 7421 prohibits a bankruptcy court from restraining the IRS from collecting trust fund taxes from a responsible person); Ray Stevens Paving Co. v. United States (*In re* Ray Stevens Paving Co.), 145 B.R. 647, 650 (D. Ariz. 1992) (same); *see also* 2 COLLIER ON BANKRUPTCY ¶ 105.02[3][e][ii], at 105-17 to 105-18 (Lawrence P. King ed., 15th ed. rev. 1996) ("[t]he majority of cases to consider the issue have found that Section 7421(a) prevents a court from enjoining government collection efforts against nondebtors[,]" including responsible persons). In fact, the First Circuit recognized this principle in *Energy Resources*. IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 233 (1st Cir. 1989) (citing tax anti-junction decisions in support of the proposition that "so long as there is 'trust fund' tax debt outstanding, nothing, including our opinion today, legally restrains the IRS from attempting to collect 'trust fund' taxes from 'responsible' individuals"), *aff'd*, 495 U.S. 545 (1990).

[563] *See In re* Laminating, Inc., 148 B.R. 259, 262 (Bankr. S.D. Tex. 1992) (concluding that *Energy Resources* does not provide any authority for overriding the Tax Anti-Injunction Act, particularly since the Supreme Court ruled "that its holding is actually in harmony with the tax code, as opposed to overriding the tax code provisions") (emphasis removed); Ray Stevens Paving Co. v. United States (*In re* Ray Stevens Paving Co.), 145 B.R. 647, 650 (D. Ariz. 1992) (same); *see also* Steven C. Bennett, *The Bankruptcy Code and the*

However, the power of bankruptcy courts to issue injunctions outside the tax context is not restricted by an anti-injunction statute. And a specific limitation on the authority of courts to restrain the IRS in the collection of taxes provides no guidance as to whether non-debtor claims of other creditors may be enjoined or released.

Second, tax allocation orders have important similarities to third-party releases. To begin with, both permit the modification of *non-debtor* obligations. The tax allocation orders upheld by the Supreme Court circumscribed the IRS's ability to collect deficiencies from third parties. In the absence of a tax allocation order, a responsible person is effectively a guarantor of the debtor's entire tax liability.[564] But with such an order, the responsible person only serves as a guarantor of the debtor's trust fund taxes. Once those debts are paid, the IRS no longer has an alternative source of recovery in the event the debtor defaults on further plan duties.[565] As the First Circuit summarized, "[T]he effect of [a tax allocation order] is to diminish the IRS's ability . . . to obtain" full recovery on all tax debts,[566] and to assist the responsible persons by decreasing "the likelihood that they will end up having personally to pay the 'trust fund' tax debts that the corporation owes."[567] Likewise, a channeling release reduces a creditor's odds of recovering in full by limiting its ability to pursue the parties shielded by the release.[568] However, while both tax allocation orders and channeling releases reduce a creditor's *chances* of receiving payment by restricting the *sources* from which the creditor may recover,[569] neither actually abrogates the creditor's legal *right* to payment. Creditors impacted by a non-debtor release must receive payment in full unless the debtor's plan of reorganization fails.[570] Similarly, tax

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Anti-Injunction Act: Collectibility of Employment Tax Liabilities from Nondebtor "Responsible Persons", 48 TAX LAW. 349, 368–69 (1995) (arguing that *Energy Resources* does not undercut the decisions holding that the Tax Anti-Injunction Act bars the bankruptcy court from stopping the IRS's attempts to collect trust fund taxes from responsible persons).

564 *Energy Res. Co.*, 871 F.2d at 232.

565 *See id.* at 225 (noting that the IRS may not seek reimbursement from responsible persons for nontrust fund taxes, such as corporate income taxes).

566 *Id.* at 233.

567 *Id.* at 225 (emphasis removed).

568 *See supra* Part III.C; *see also supra* notes 49–53 and accompanying text (discussion of channeling releases in the taxonomy section); *supra* notes 72–77 and accompanying text (comparison of channeling releases and provisional injunctions in the taxonomy section).

569 *See In re* Digital Impact, Inc., 223 B.R. 1, 9 (N.D. Okla. 1998) (observing that in cases involving channeling releases, "[t]he claimants were not prevented from litigating their claims or from being full compensated; only the *source* of compensation was limited") (emphasis added).

570 *See supra* notes 348–51 and accompanying text.

designations may not be used to reduce the IRS's recovery under a chapter 11 plan, unless the debtor defaults on its reorganization obligations.[571] Finally, at least one court has observed that a tax allocation order is "the functional equivalent of a discharge for specific debts"[572]—i.e., a release. Indeed, the district court in the Newport bankruptcy described the tax designation provision in the debtor's plan as "exculpatory."[573] Given the parallels between tax allocation orders and third-party releases, the fact that the former do not actually extinguish claims is not a critical difference.

Third, nothing in *Energy Resources* suggests that tax designation orders fall at the outer boundaries of a bankruptcy court's authority under §§ 105(a) and 1123(b)(6). If anything, the decision implies that the equitable powers conferred by the Code stretch well beyond the capacity to grant that type of relief. The Supreme Court's analysis of whether §§ 105(a) and 1123(b)(6) permit bankruptcy judges to designate tax payments consisted of a *single sentence*. After quoting the two equitable statutes, the Court summarily concluded that those laws "are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships."[574] That was the High Court's *entire* discussion of whether §§ 105(a) and 1123(b)(6) provide bankruptcy courts with the power to allocate tax payments.[575] Immediately thereafter, the Court turned to whether tax designation orders conflict with other provisions of the Code or nonbankruptcy law.[576] If the Justices had thought that such orders are near the periphery of a bankruptcy court's equitable authority, they likely would have presented far more analysis of §§ 105(a) and 1123(b)(6).

While the objection to non-debtor releases based on the limited nature of tax allocation orders fails, it should be noted that a number of courts have tried to confine the impact of *Energy Resources* by interpreting its holding

[571] *See infra* notes 580, 587, and accompanying text.

[572] Wetherbee v. Willow Lane, Inc. (*In re* Bestway Products, Inc.), 151 B.R. 530, 538 n.27 (Bankr. E.D. Cal. 1993) (citing *Energy Resources* for the proposition that "it may be permissible in extraordinary circumstances to approve the functional equivalent of a discharge for specific debts for someone other than the debtor pursuant to an order confirming a chapter 11 plan of reorganization"), *aff'd*, 165 B.R. 339 (B.A.P. 9th Cir. 1994).

[573] Petitioner's Brief, *supra* note 438, at 8 (apparently quoting a transcript of the district court's ruling from the bench).

[574] United States v. Energy Res. Co., 495 U.S. 545, 549 (1990).

[575] *Id.*

[576] *Id.* at 549–51.

narrowly.[577] For example, the Supreme Court ruled that tax designation orders are permissible if "necessary to the success of a *reorganization* plan."[578] Strictly construing this language, several courts have held that allocation is impermissible where the debtor is *liquidating* under either chapter 7 or chapter 11 because a designation in those contexts is not essential to a plan of reorganization.[579] And some decisions refused allocations where the effect was to diminish the IRS's total recovery from the debtor.[580] Commentators have also embraced a restrictive interpretation of *Energy Resources*.[581]

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[577] *See, e.g.*, United States v. Pepperman, 976 F.2d 123, 129–30 (3d Cir. 1992) ("The vast majority of courts that have addressed the issue of the scope of the *Energy Resources* decision have declined to extend its application beyond the Chapter 11 reorganization context.") (collecting authorities); *In re* T. Craft Aviation Serv., Inc., 187 B.R. 703, 710 (N.D. Okla. 1995) ("Circuit-level cases applying *U.S. v Energy Resources, Inc.* have read it strictly and applied it narrowly, so as to favor IRS as against corporate debtors-in-possession and their tax-dodging principals.") (collecting authorities); *In re* Burgess, 171 B.R. 227, 229 (Bankr. E.D. Tex. 1994) ("Courts which have interpreted *Energy Resources* have basically limited the holding to its facts.") (collecting authorities); *see also* Kimberly Ann De Bias, *Draining the Power of* Energy Resources*: Subsequent Case Law Preserves the Utility of I.R.C. § 6672*, 65 TEMP. L. REV. 541, 544 (1992) ("However, subsequent courts' decisions addressing the issue of designation of tax payments in bankruptcy situations have been reluctant to apply *Energy Resources* and have limited the decision largely to its facts.").

[578] *Energy Res.*, 495 U.S. at 548–49 (emphasis added).

[579] *See, e.g.*, United States v. Kare Kemical, Inc. (*In re* Kare Kemical, Inc.), 935 F.2d 243, 244 (11th Cir. 1991) (holding that *Energy Resources* does not apply to chapter 11 liquidations because any allocations in that context are not necessary for the success of a reorganization); Sonntag v. United States (*In re* Equip. Fabricators, Inc.), 127 B.R. 854, 858 (D. Ariz. 1991) (same); *In re* Gregory Engine & Mach. Servs., Inc., 135 B.R. 807, 810 (Bankr. E.D. Tex. 1992) (holding that the power to allocate tax payments may not be exercised in chapter 7 bankruptcies because any such designation will not facilitate a reorganization by the debtor); Milligan v. Davis (*In re* C.J. Milligan, Inc.), 252 B.R. 465, 468 (Bankr. E.D. Mo. 2000) (same); *see also* United States v. Pepperman, 976 F.2d 123, 130 (3d Cir. 1992) (observing that the majority of decisions have limited the power to allocate to chapter 11 reorganizations because "the Court in *Energy Resources* consistently linked its holding with the fact of reorganization and the debtor's need for rehabilitation"); *In re* Laminating, Inc., 148 B.R. 259, 261 (Bankr. S.D. Tex. 1992) (noting that the majority of cases have restricted *Energy Resources* to reorganizations because of that decision's emphasis on allocation "as a tool to aid in rehabilitating a debtor, a rationale that is not present in liquidation proceedings").

[580] *See, e.g.*, *Burgess*, 171 B.R. at 230 (denying allocation of tax payments to older tax years and penalties requested in a chapter 13 reorganization where the effect would have been to discharge a greater portion of the IRS's claim); *In re* Baker, No. 95-30947 HCD, 1996 WL 571764, at *8-*10 (Bankr. N.D. Ind. Jul. 2, 1996) (holding that, while *Energy Resources* extends to *chapter 13* reorganizations, allocation of payments to more recent tax years was not permissible here because it would discharge a greater portion of the IRS's claim against the debtors); *see also* IRS v. Kaplan (*In re* Kaplan), 104 F.3d 589, 597 (3d Cir. 1997) (holding that the court in the bankruptcies of two responsible persons could not order the IRS to allocate payments made by the corporate employer to trust fund taxes first where the employer itself was not in bankruptcy); *id.* at 598 (ruling that the bankruptcy court could not retroactively designate to trust fund taxes the corporate employer's payments to the IRS made before it entered bankruptcy).

[581] *See, e.g.*, Camp, *supra* note 533, at 329 (contending that *Energy Resources* should not be extended to chapter 11 liquidations and that ex post facto allocations should also be prohibited); Tal Marnin, Note, *Trust Fund Taxes in Chapter 11 Liquidations: A Challenge to* Energy Resources, 3 AM. BANKR. INST. L. REV. 231, 235 (1995) ("This Note concludes that *Energy Resources* should be narrowly construed so as to apply only to true Chapter 11 reorganizations . . . .").

However, other courts have adopted an expansive understanding, focusing upon the Supreme Court's embrace of "the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships."[582] These courts are critical of any attempt to draw a bright line between reorganizations and other bankruptcy proceedings.[583] Decisions in this line have extended the allocation power to liquidations under chapter 11[584] and even chapter 7.[585]

Fortunately, I do not need not take sides in this ongoing debate. As noted above, I do not believe that non-debtor releases are permissible when the

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582 *Energy Res.*, 495 U.S. at 549. *See, e.g.*, *In re* T. Craft Aviation Serv., Inc., 187 B.R. 703, 709 (Bankr. N.D. Okla. 1995) ("The Supreme Court never stated that 'orders of the type here' were permissible only where 'necessary to ensure the success of [a] reorganization.' A fair reading of the case is that Bankruptcy Courts may make allocation orders in various circumstances as part of their 'broad authority to modify debtor-creditor relationships,' *for example* to ensure the 'success of a reorganization . . . .'"); *In re* Taubman, 160 B.R. 964, 980 (Bankr. S.D. Ohio 1993) ("[I]n the absence of a prohibitive provision of the Bankruptcy Code, this court remains directed to give overriding consideration to equitable principles [reflected in § 105(a)].") (citing, *inter alia*, *Energy Res.*, 495 U.S. at 549).

583 *See, e.g.*, *T. Craft Aviation Serv.*, 187 B.R. at 709–10 (criticizing decisions ruling that the "*only* basis for an allocation order is necessity to success of a reorganization plan" in light of the fact that the Supreme Court "spoke in much more general terms of the 'broad residual authority' of the Bankruptcy Court"); *In re* Flo-Lizer, Inc., 164 B.R. 79, 82 (Bankr. S.D. Oho 1993) (disagreeing with those courts that have read *Energy Resources* narrowly and holding that the Supreme Court did not draw a "bright line between a non-liquidating Chapter 11 plan, and all other bankruptcy proceedings"), *aff'd*, 164 B.R. 749 (S.D. Ohio 1994). Admittedly, some judges have adopted this construction reluctantly. *See, e.g.*, *T. Craft Aviation Serv.*, 187 B.R. at 709–10 ("Although the Supreme Court's opinion supports the 'broad authority' of Bankruptcy Courts, it endorses a questionable use of such authority.").

584 *See, e.g.*, United States v. Deer Park, Inc. (*In re* Deer Park, Inc.), 136 B.R. 815, 818 (B.A.P. 9th Cir. 1992) ("We hold that the *Energy Resources* decision applies to a Chapter 11 liquidating plan as it is a valid form of reorganization provided for in the reorganization chapter of the Bankruptcy Code."), *aff'd*, 10 F.3d 1478 (9th Cir. 1993); *In re* Flo-Lizer, Inc., 164 B.R. 79, 82 (Bankr. S.D. Oho 1993) (holding that *Energy Resources* applies to chapter 11 liquidations), *aff'd*, 164 B.R. 749 (S.D. Ohio 1994). In *Flo-Lizer*, the court granted an allocation of tax payments because the responsible persons agreed to continue working for the debtor without compensation, waived their priority wage claims, and contributed "significant personal assets" to the debtor's liquidating chapter 11 plan. *Id*. Without this assistance, the debtor would have been forced into chapter 7 where the distributions to creditors would have been minimal. *Id.* at 81. The judge thus concluded that the allocation was necessary to the success of the liquidating plan and therefore justified under the Code. *Id.* at 82. The *Flo-Lizer* court did, however, emphasize "the limited and unique circumstances here that call for the allowance of the requested designation. Most liquidating chapter 11 proceedings would not fit within the parameters required to allow for such a ruling." *Id.* at 82; *see also Deer Park*, 136 B.R. at 819 (granting an allocation of payments to trust fund taxes where the responsible person, in reliance upon the designation, provided services to the debtor necessary to the success of the chapter 11 liquidating plan).

585 *See, e.g.*, *T. Craft Aviation Serv.*, 187 B.R. at 710 (holding that under *Energy Resources* bankruptcy courts have the authority to allocate tax payments in chapter 7 bankruptcies, but that such a designation was inappropriate in this case); *see also* United States v. Pepperman, 976 F.2d 123, 130 (3d Cir. 1992) (leaving open the possibility that allocation may be permissible in a chapter 7 case if it can be shown that the designation is "necessary or appropriate to carry out the provisions of the" Code under § 105(a)).

debtor is liquidating.[586] And the cases barring tax designation orders that decrease the IRS's total recovery are consistent with the prohibition on actual releases that I endorsed earlier—third-party releases are impermissible when the impacted creditors are not promised payment in full on the extinguished claims.[587]

In short, the limitations that some authorities have placed on *Energy Resources* are simply irrelevant to the validity of non-debtor releases in chapter 11 reorganizations where the modified *Master Mortgage* test is satisfied.

3. *The Equitable Authority of Bankruptcy Courts to Allocate the Risk of Plan Failure*

There is one, final anti-release argument based upon the two equitable statutes that must be addressed before I may conclude that §§ 105(a) and 1123(b)(6) provide bankruptcy courts with sufficient power to issue third-party releases. According to this objection, even if the broad view of §§ 105(a) and 1123(b)(6) is correct, non-debtor releases do not comport with equity because they place the risk of plan failure on the releasing creditor rather than the benefiting non-debtor.[588] Therefore, a bankruptcy court's equitable powers only permit the issuance of provisional injunctions; non-debtor releases are prohibited.[589]

However, in *Energy Resources*, the Supreme Court held that bankruptcy courts may use the equitable authority granted by §§ 105(a) and 1123(b)(6) to issue orders that shift the risk of plan default from a third party to a creditor.[590] The High Court also ruled that such orders are permissible whenever it is

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586 *See supra* notes 333–38 and accompanying text.

587 Tax allocation orders that decrease the IRS's recovery potentially violate the "best-interests" test of § 1129(a)(7) because they effectively discharge tax liabilities that the government would otherwise recover if the debtor liquidated. *Cf. In re* Senise, 202 B.R. 403, 410 (Bankr. D.S.C. 1996) ("The Supreme Court specifically limited its holding to the facts by stating that the designation order does not compromise the Government's right under the Bankruptcy Code to be assured that its full tax claim will be paid off in six years."); *In re* Burgess, 171 B.R. 227, 230 (Bankr. E.D. Tex. 1994) ("*Energy Resources* should not be interpreted as enlarging a bankruptcy court's equitable powers to include the avoidance of a tax liability 'which would in the ordinary course of things be nondischargeable.'") (quoting *In re* Lambert, 124 B.R. 345, 347 (Bankr. W.D. Okla. 1991)); *In re* Baker, No. 95-30947 HCD, 1996 WL 571764, at *8-*10 (Bankr. N.D. Ind. Jul. 2, 1996) (same).

588 As noted previously, plans of reorganization containing channeling releases generally do not guarantee that creditors impacted by the release will receive payment in full on their claims. *See supra* notes 77–78 and accompanying text; *see generally supra* Part III.C.

589 *See supra* Part III.C.

590 United States v. Energy Res. Co., 495 U.S. 545, 548–50 (1990).

necessary to the success of a reorganization.[591] *Energy Resources* thus undermines the contention that non-debtor releases improperly shift the risk of plan failure from non-debtors to creditors and demonstrates that this type of relief is entirely equitable.

Tax allocation orders decrease the likelihood that the IRS will receive payment in full because they mandate that liabilities guaranteed by a third party—the liabilities for trust fund taxes—be extinguished first.[592] Should the plan fail after the debtor has paid its trust fund taxes, but before all *non*trust fund tax debts are satisfied, the IRS has no alternative source from which to recover its deficiency.[593] In the absence of a tax designation order, however, the IRS may apply the debtor's chapter 11 payments to the nonguaranteed liabilities first. This application protects the IRS because, if the debtor defaults, the responsible person remains liable for any outstanding trust fund taxes. Therefore, tax allocation orders shift the risk of plan failure from the guarantors of the debtor's tax obligations (responsible persons) to the IRS by circumscribing the government's ability to pursue the guarantors in the event of a default.[594]

Non-debtor releases have precisely the same effect in comparison to provisional injunctions—they decrease the likelihood that a creditor will receive payment in full by permanently barring the creditor from pursuing a co-obligor of the debtor rather than merely restraining the creditor from such action temporarily or until the debtor defaults.[595] To illustrate, the channeling release in *Robins* prevented the Dalkon Shield claimants from attempting to recover against the debtor's coliable joint tort-feasors.[596] If the A.H. Robins plan had failed before the tort creditors received full payment for their injuries, the creditors would have possessed no alternative source of recovery. But if the plan had merely contained a provisional injunction, the Dalkon Shield claimants could have pursued other parties responsible for their injuries in the

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591 *Id.* at 549.

592 *Id.* at 550.

593 *Id.*

594 *See id.* at 548–50.

595 Channeling non-debtor releases may also extinguish independent claims against third parties and transfer the responsibility of payment to the debtor. But generally channeling releases involve a debtor and a third party that are co-obligors. *See supra* notes 53–54 and accompanying text.

596 *See* Menard-Sanford v. Mabey (*In re* A.H. Robins Co.), 880 F.2d 694, 700–01 (4th Cir. 1989); *see also In re* Dow Corning Corp., 287 B.R. 396, 415–16 (E.D. Mich. 2002) (the debtor's plan contained a non-debtor release that barred purchasers of silicone breast implants from suing the debtor's shareholders, who were alleged to be joint tort-feasors with Dow Corning).

event of a default. Thus, by including a channeling non-debtor release instead of a provisional injunction, the A.H. Robins plan of reorganization transferred the risk of plan failure from third parties to creditors, just like the tax allocation orders in *Energy Resources*.

In sum, the type of risk shifting endorsed by *Energy Resources* is nearly identical to that which takes place if a non-debtor release is contained in a chapter 11 plan rather than a provisional injunction. And the Supreme Court held that it is appropriate to reallocate risk in this manner when such action is necessary to the success of a reorganization.[597] Therefore, the argument that channeling releases are inequitable must be rejected. A bankruptcy court's power under §§ 105(a) and 1123(b)(6) is not limited to the issuance of provisional injunctions.

Significantly, the Supreme Court ignored the contention of Newport and the Energy Resources trustee that subjecting the IRS to the possibility of plan failure is sanctioned by § 1129(a)(9)(C)[598]—the statute that allowed a reorganizing debtor to pay its taxes within six years from the date of assessment.[599] The Supreme Court apparently found no need to rely upon that provision and instead focused entirely on §§ 105(a) and 1123(b)(6) in assessing whether it is equitable to shift the risk of plan default from a non-debtor to a creditor.[600] This thwarts any counterargument that it is permissible to alter the risk of plan failure only in the tax context where § 1129(a)(9)(C) is applicable.

It is not surprising that the Supreme Court disregarded the respondents' § 1129(a)(9)(C) defense of tax allocation orders. First, debtors are generally permitted to pay their creditors over extended periods of time lasting well beyond six years.[601] Section 1129(a)(9)(C) thus grants the IRS a *privilege* most other creditors do not receive—all of its claims must be paid within six years of the date the taxes were assessed.[602] In effect, § 1129(a)(9)(C) is intended to *reduce* the level of risk that may be imposed on the government in

597 *See Energy Res.*, 495 U.S. at 546, 549.

598 *See* Respondents Brief, *supra* note 491, at 38; *Energy Res.*, 495 U.S. at 546–51.

599 11 U.S.C. § 1129(a)(9)(C) (2000). See *supra* note 430 for a discussion of a recent amendment to this statute.

600 *Energy Res.*, 495 U.S. at 549.

601 *See, e.g.*, *In re* McCall, No. 93-00632, 1997 WL 428580, at *3, *16 (Bankr. D.D.C. May 27, 1997) (creditors impacted by the channeling release scheduled to receive distributions over eight- or ten-year periods); *In re* Master Mortgage Invest. Fund, Inc., 168 B.R. 930, 932 (Bankr. W.D. Mo. 1994) (plan provided creditors would be paid over twenty years).

602 § 1129(a)(9)(C). See *supra* note 430 for a discussion of a recent amendment to this statute.

a plan of reorganization. It would be strange to interpret a statute designed to provide the IRS with additional protection as authorizing orders that actually lessen the government's chances of recovery. Second, to the extent § 1129(a)(9)(C) does apportion risk to the IRS, it does so in a manner that is entirely distinct from the way that tax designation orders do. The statute permits a chapter 11 debtor to pay the IRS over time. But tax allocations limit the IRS's ability to pursue third parties. Moreover, § 1129(a)(9)(C) shifts risk from the *debtor* to the IRS. Allocation orders, in contrast, move risk from *non-debtors* to the government. Accordingly, as the Supreme Court correctly implied, § 1129(a)(9)(C) cannot be read as supporting the bankruptcy court's authority to grant tax designations. The power to shift the risk of plan failure approved of in *Energy Resources* flows solely from §§ 105(a) and 1123(b)(6).

With the defeat of the final anti-release objection centered on §§ 105(a) and 1123(b)(6), it is now clear that the pro-release authorities are correct about the scope of a bankruptcy court's equitable powers—they are sufficiently broad to permit the granting of channeling non-debtor releases. But §§ 105(a) and 1123(b)(6) may not be used in a manner that conflicts with another provision of the Code. And the most well-accepted argument against non-debtor releases is that they are prohibited by § 524(e). It is to this argument that I now turn.

B. Energy Resources *and § 524*

The majority of anti-release courts, as well as several commentators, believe that the language of § 524(e) prohibits non-debtor releases.[603] Several of these authorities bolster their conclusion by reference to practice under prior laws[604] and to what they perceive to be the policy behind § 524(e)—that bankruptcy only offers protection to debtors willing to submit fully to the jurisdiction of the system.[605] Pro-release courts and commentators counter that the express words of § 524(e) merely identify the impact of the debtor's discharge; the statute says nothing about the power of a bankruptcy judge to extinguish claims via an independent order issued pursuant to § 105(a) or § 1123(b)(6).[606] Given the statute's clear language, previous versions of § 524(e) and any policies underlying that provision are simply irrelevant.[607]

603 *See supra* note 194 and accompanying text.
604 *See supra* notes 174–76 and accompanying text.
605 *See supra* notes 195–204 and accompanying text.
606 *See supra* notes 278–80 and accompanying text.
607 *See supra* notes 281–83 and accompanying text.

Pro-release authorities thus conclude that § 524(e) does not bar third-party releases.

Energy Resources provides the answer yet again. That case establishes that the Supreme Court's "plain-meaning" approach to statutory interpretation applies when considering whether an order issued under the equitable statutes conflicts with a more specific provision of the Code. Therefore, since the clear language of § 524(e) fails to prohibit or even address non-debtor releases, the statute does not bar such relief.

Supreme Court precedent firmly settles that if the words of a statute are clear, the provision must be understood according to its plain meaning.[608] The Court has consistently used this interpretive approach in construing the Bankruptcy Code.[609] And it did so in *Energy Resources*.

There, the IRS contended that tax allocation orders conflict with three provisions of the Bankruptcy Code.[610] The first, § 507(a)(8), grants priority status to various tax claims.[611] The second, § 523(a)(1)(A), makes such priority claims nondischargeable in the bankruptcy of an individual debtor: "A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt for a tax or a customs duty of the kind and for the periods specified in section 507(a)(2) or 507(a)(8)

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[608] *See* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) ("[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.") (internal quotation marks omitted) (quoting United States v. Ron Pair Enters., Inc. 489 U.S. 235, 241 (1989)); U.S. Nat'l Bank of Or. v. Independent Ins. Agents of America, Inc., 508 U.S. 439, 454 (1993) ("A statute's plain meaning must be enforced . . . ."); Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253–54 (1992) ("We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: judicial inquiry is complete.") (citations and internal quotation marks omitted).

[609] *See, e.g.*, Lamie v. U.S. Trustee, 540 U.S. 526, 534 (2004) ("It is well established that 'when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms.'" (quoting *Hartford Underwriters*, 530 U.S. at 6)) (construing various provisions of the Bankruptcy Code); *Ron Pair Enters.*, 489 U.S. at 240–41 ("[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute.") (holding that the language of 11 U.S.C. § 506(b) (2000) with respect to postpetition interest for oversecured creditors is sufficiently clear to avoid referring to legislative history); *id.* at 242 ("The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of the drafters.'") (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)).

[610] Petitioner's Brief, *supra* note 438, at 32–33; Reply Brief, *supra* note 459, at 14.

[611] 11 U.S.C. § 507(a)(8) (2000).

of this title . . . ."[612] And the third, § 1129(a)(9)(C), required that the holder of a priority tax claim receive payment in a chapter 11 case within six years of the date of assessment:

> [W]ith respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the [chapter 11] plan, equal to the allowed amount of such claim.[613]

These statutes, however, say nothing about the allocation of tax payments. As the Supreme Court elucidated,

> It is evident that these restrictions on a bankruptcy court's authority do not preclude the court from issuing orders of the type at issue here, for those restrictions do not address the bankruptcy court's ability to designate whether tax payments are to be applied to trust fund or non-trust-fund tax liabilities.[614]

In other words, since nothing in the language of §§ 507(a)(8), 523(a)(1)(A), and 1129(a)(9)(C) concerned the allocation of tax payments, those provisions do not forbid tax designation orders.

Comparable reasoning is applicable to the asserted conflict between § 524(e) and non-debtor releases issued under § 105(a) or § 1123(b)(6). Section 524(e) states 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."[615] Like the specific provisions in *Energy Resources*, this statute says nothing about the allegedly contradictory use of the equitable statutes; § 524(e) makes no mention of third-party releases. Instead, as explained by many pro-release (and even a few anti-release) authorities, the plain language of the legislation simply identifies the impact of the debtor's discharge—the discharge, *by itself*, does not "affect the liability" of any third party. Section

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612 § 523(a)(1)(A).

613 § 1129(a)(9)(C). See *supra* note 430 for a discussion of a recent amendment to this statute.

614 United States v. Energy Res. Co., 495 U.S. 545, 550 (1990); *accord* Energy Res. Co. v. IRS (*In re* Energy Res. Co.), 871 F.2d 223, 231 (1st Cir. 1989) ("[N]othing in the bankruptcy statute limits, in any relevant way, the bankruptcy court's power to allocate [payments] when the creditor is the IRS."), *aff'd*, 495 U.S. 545 (1990).

615 § 524(e).

524(e) leaves open the prospect of orders, *independent* of the discharge, that *otherwise* affect the liability of non-debtors.[616]

At least two decisions from anti-release jurisdictions—more specifically, from jurisdictions in which courts have found that § 524(e) prohibits third-party releases—concede that § 524(e) does not expressly bar non-debtor releases.[617] Perhaps that is why a number of anti-release authorities attempted to reinforce their position by highlighting (1) the operation of § 524(e)'s predecessors under the Bankruptcy Act, and (2) what they contend is the policy behind the statute.[618] On the latter point, anti-release courts and commentators assert that the elimination of debts, the primary form of bankruptcy relief, should only be available to parties that file for bankruptcy—i.e., to parties that grant the courts full authority over their financial affairs.[619] When a court eliminates the liabilities of non-debtors, it provides this cardinal bankruptcy remedy without demanding that the beneficiary observe the Code's parallel obligations,[620] upsetting the "careful balance between . . . debtor's rights and . . . creditor's rights that Congress struck in creating the bankruptcy system . . . ."[621]

However, the IRS made a virtually identical structural argument in *Energy Resources*, contending that tax allocation orders disrupt "the balance struck by

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616 *See supra* notes 278–83 and accompanying text.

617 In Republic Supply Co. v. Shoaf, 815 F.2d 1046 (5th Cir. 1987), the Fifth Circuit stated that § 524(e) "does not by its specific words preclude" third-party releases. *Id.* at 1050 (further concluding that res judicata barred any contention that the third-party release at issue was invalid). However, subsequently the same court held that the statute does prohibit such relief. *See* Feld v. Zale Corp. (*In re* Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995). Similarly, while the Tenth Circuit ruled that § 524(e) bars non-debtor releases in 1990, *see* Landsing Div. Properties-II v. First Nat'l Bank and Trust Co. of Tulsa (*In re* W. Real Estate Fund, Inc.), 922 F.2d 592, 601–02 (10th Cir. 1990), a district court within that circuit subsequently offered an alternative understanding of the statute, *see In re* Digital Impact, Inc., 223 B.R. 1, 10 (N.D. Okla. 1998) ("This Court does not believe that Section 524(e) was intended to prohibit [non-debtor] releases. Rather, Section 524(e) was intended to insure that co-debtors or guarantors (who are not debtors in the bankruptcy case), and their property, are not automatically released from the debt or guaranty upon the discharge of a debtor, and that rights of creditors are not impaired by the debtor's discharge.") (emphasis removed). The district court ultimately concluded that non-debtor releases are invalid in light of the narrow view of § 105(a). For a fuller discussion of *Digital Impact*, see *supra* notes 205–09 and accompanying text; *see also* Keene Corp. v. Acstar Ins. Co. (*In re* Keene Corp.), 162 B.R. 935, 947 (Bankr. S.D.N.Y. 1994) ("Although Section 524(e) speaks in terms of 'discharge', [sic] its scope is greater.") (ruling that § 524(e) prohibits bankruptcy court orders that prevent creditors from enforcing disallowed and subordinated claims against guarantors, sureties and escrows).

618 *See supra* notes 175, 195–204, and accompanying text.

619 *See supra* notes 195–99 and accompanying text.

620 *See supra* notes 200–01 and accompanying text.

621 Bill Roderick Distrib., Inc. v. A.J. Mackay Co. (*In re* A.J. Mackay Co.), 50 B.R. 756, 761 (D. Utah 1985); *see also supra* notes 202–04 and accompanying text.

Congress" in §§ 507(a)(8), 523(a)(1)(A), 1129(a)(9)(C) and elsewhere in the Code concerning tax collection and competing bankruptcy policies.[622] And the *Energy Resources* Court offered a concise rebuttal to this position: while a prohibition on tax designation orders "might be desirable from the Government's standpoint, it is an added protection *not specified in the Code itself*."[623] Once again, the plain language of the Code controlled. Similarly, given the clear wording of § 524(e), there is no need to consider either § 524(e)'s policies or its antecedents; a prohibition on non-debtor releases is "not specified" in that statute.

It is true that some pro-release authorities criticized the anti-release position with respect to § 524(e) by observing that the Supreme Court generally takes a plain-meaning approach to the Code.[624] But these authorities overlooked *Energy Resources*. The significance of that case is this: *Energy Resources* demonstrates that the plain-meaning approach applies in precisely the circumstances of the non-debtor release debate—when courts address whether specific sections of the Bankruptcy Code limit the equitable powers conferred by §§ 105(a) and 1123(b)(6). In fact, the High Court used the same interpretive methodology in addressing whether tax allocation orders contravene the *nonbankruptcy* statute at issue in that case. In response to the government's contention that tax designations conflict with § 6672 of the Internal Revenue Code[625] because they permit debtors to pay their nonguaranteed liabilities first, the Court simply offered this: "§ 6672, *by its terms*, does not protect against this eventuality."[626] In short, *Energy Resources* lends considerable additional weight to the pro-release understanding of § 524(e).

While a plain-meaning approach to the relationship of §§ 105(a), 1123(b)(6), and 524(e) supports the legitimacy of non-debtor releases, such a methodology might be invalid if it led to an absurd result.[627] Thus, for example, if the pro-release construction of § 524(e) made the statute pointless or redundant, recourse to extra-textual sources would be appropriate. But the pro-release interpretation is entirely reasonable. Under that reading, § 524(e)'s

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[622] Reply Brief, *supra* note 459, at 12–13; *accord* Petitioner's Brief, *supra* note 438, at 32–33.

[623] United States v. Energy Res. Co., 495 U.S. 545, 550 (1990) (emphasis added).

[624] *See supra* notes 281–82 and accompanying text.

[625] 26 U.S.C. § 6672 (2000).

[626] *Energy Res. Co.,* 495 U.S. at 551 (emphasis added).

[627] *See* Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000) ("[W]hen the statute's language is plain, the sole function of the courts—at least where the disposition required by the text *is not absurd*—is to enforce it according to its terms.") (internal quotation marks omitted) (emphasis added).

purpose is to prevent the release of co-obligors by operation of law. As noted in the general introduction to § 524,[628] without § 524(e), the debtor's discharge might automatically extinguish claims of guarantors and other co-obligors under nonbankruptcy law governing suretyship, which provides that the release of a primary obligor discharges any party that is secondarily liable.[629] Bankruptcy would therefore severely undermine the effectiveness of contractual guaranties, among other detrimental results. Section 524(e) prevents any such outcome.

One commentator disputes this reasoning. Section 524(a) specifies that a discharge only (1) voids judgments that establish "personal liability of the *debtor*," and (2) enjoins efforts to recover claims "as a personal liability of the *debtor*."[630] Peter Meltzer contends, therefore, that § 524(e) is redundant on the pro-release understanding; § 524(a) already limits the impact of the discharge to the debtor in bankruptcy.[631] But § 524(a) is not sufficiently specific. Subsection (a) says nothing that would prevent *nonbankruptcy law* from treating the discharge of the debtor as a release of a co-obligor; it simply does not discuss the possible indirect impacts of the discharge on third parties pursuant to other law. That is why § 524(e) is necessary. It expressly overrides any federal or state legal principles that would exculpate third parties in light of the debtor's discharge: "[D]ischarge of a debt of the debtor does not *affect* the liability of *any other entity* on . . . such debt."[632]

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[628] *See supra* note 156 and accompanying text.

[629] Brubaker, *supra* note 27, at 971–72 & n.46 (citing RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY §§ 39-44 & intro. note, at 167 (1996)); *accord* Feldstein, *supra* note 27, at 30 ("[W]ithout section 524(e), the discharge of a principal obligor in bankruptcy might be construed to exonerate a guarantor or to provide other suretyship defenses under applicable state law . . . ."); *see also In re* Digital Impact, Inc., 223 B.R. 1, 10 (N.D. Okla. 1998) ("Section 524(e) was intended to insure that co-debtors or guarantors . . . are not automatically released from the debt or guaranty upon the discharge of a debtor . . . .") (emphasis removed).

[630] 11 U.S.C. § 524(a)(1), (2) (2000) (emphasis added).

[631] Meltzer, *supra* note 27, at 8–10.

[632] § 524(e) (emphasis added); *see also* Feldstein, *supra* note 27, at 30 ("[S]ection 524(e) makes clear that the discharge afforded the debtor/principal obligor under section 524(a) was not intended to benefit or affect the liabilities of third parties for the obligations of the debtor.").

Meltzer also contends that reading § 524(e) to permit releases is inconsistent with the broad view of § 105(a): "Paradoxically, this . . . requires simultaneously a narrow approach to § 524(e) and a broad approach to § 105(a)." Meltzer, *supra* note 27, at 22 n.69. But the *Energy Resources* Court adopted just such a "paradoxical" approach to the Code when it embraced the broad view of §§ 105(a) and 1123(b)(6) and a strict construction of §§ 507(a)(8), 523(a)(1)(A), and 1129(a)(9)(C). *See* United States v. Energy Res. Co., 495 U.S. 545, 549–50 (1990). The Court's interpretive conclusions are well-justified. Like § 524(e), §§ 507(a)(8), 523(a)(1), and 1129(a)(9)(C) are narrowly drafted provisions. Sections 105(a) and 1123(b)(6), on the other hand, are not. Section 105(a), in particular, provides that bankruptcy courts "may issue *any* order, process or judgment that is necessary or appropriate to carry out the provisions of this title." § 105(a) (emphasis added). This wording is exceedingly broad. *See* Fairchild Dornier GMBH v. Official Comm. of Unsecured Creditors

When interpreted through the lens of the Supreme Court's plain-meaning approach, § 524(e) does not bar third-party releases. The statute simply contains no prohibitory language. Accordingly, the last of the primary issues concerning the validity of non-debtor releases must be decided in favor of the pro-release position.

My analysis is not complete, however. Two additional arguments warrant consideration. The first is a challenge to third-party releases based upon § 524(a) (as opposed to § 524(e)), and is addressed immediately below. The second is a counterargument that flows from the language of *Energy Resources* itself and is presented in Part V.C.

In *American Hardwoods*, the Ninth Circuit used § 524(a) to support its conclusion that non-debtor releases are forbidden. The release sought in that case took the form of a permanent injunction.[633] The court ruled that the requested injunction was indistinguishable from a discharge: "A discharge under section 524(a)(2) does not void *ab initio* a liability. Rather, section 524 constructs a legal bar to its recovery. A discharge is in effect a special type of

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(*In re* Official Comm. of Unsecured Creditors For Dornier Aviation, N.A., Inc.), 453 F.3d 225, 231 (4th Cir. 2006) ("In light of the broad language of § 105(a) . . . ."); Plastiras v. Idell (*In re* Sequoia Auto Brokers, Ltd., Inc.), 827 F.2d 1281, 1290 (9th Cir. 1987) (noting that § 105(a) contains "broad, general language"); 2 COLLIER ON BANKRUPTCY ¶ 105.01, at 105-5 to 105-6 (Lawrence P. King ed., 15th ed. rev. 2004) ("Section 105(a) is an omnibus provision phrased in such general terms as to be the basis for a broad exercise of power in the administration of a bankruptcy case."). As the Eleventh Circuit has explained:

> [Section] 105 uses the broad term "any" which encompasses all forms of orders including those that award monetary relief. The term "any" should be given this broad construction under the "settled rule that a statute must, if possible, be construed in such fashion that every word has some operative effect." United States v. Nordic Village, 503 U.S. 30, 36 (1992) (parallel citations omitted). The broad term "any" is only limited to those orders that are "necessary or appropriate" to carry out the Bankruptcy Code. Therefore, the plain meaning of § 105(a) encompasses *any* type of order, whether injunctive, compensative, or punitive, as long as it is "necessary or appropriate to carry out the provisions of" the Bankruptcy Code.

In re Jove Engineering, Inc. v. IRS, 92 F.3d 1539, 1554 (11th Cir. 1996). The provision is so expansive that courts hesitate to give full effect to its "literal breadth." *See* 641 Assoc., Ltd. v. Balcor Real Estate Fin., Inc. (*In re* 641 Assoc., Ltd.), Bankr. No. 91-11234S, Adv. Nos. 93-0363S, 93-0456S, 1993 WL 332646, at *7 (Bankr. E.D. Pa. Aug. 26, 1993) ("Despite the possible interpretation of the literal breadth of [§ 105(a)] to allow a bankruptcy court to do *anything*, even *sua sponte*, irrespective of state law, federal law, or other Code provisions to the contrary . . . , applicable case authority has limited the powers of the bankruptcy court under this Code section."); *accord* Noonan v. Sec'y of Health and Human Serv. (*In re* Ludlow Hosp. Soc., Inc.), 124 F.3d 22, 27 (1st Cir. 1997) ("Although expansively phrased, § 105(a) affords bankruptcy courts considerably less discretion than first meets the eye . . . ."). Accordingly, there is no "paradox" in reading § 524(e) narrowly and §§ 105(a) and 1123(b)(6) expansively.

[633] Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 622 (9th Cir. 1989).

permanent injunction. [Debtor] seeks the same."[634] Therefore, "the specific provisions of section 524 *displace* the court's equitable powers under section 105 to order the permanent relief sought by American [Hardwoods]."[635]

While no other decision has endorsed the Ninth Circuit's § 524(a) argument,[636] the court's contention that § 524(a) "displaces" the authority to issue a non-debtor release under § 105(a) is exemplative of a general approach to the equitable statutes adopted in other federal courts. As articulated by the Seventh Circuit, "when a specific Code section addresses an issue, a court may not employ its equitable powers to achieve a result not contemplated by the Code."[637] In other words, even if a requested § 105(a) order is not *expressly forbidden* by anything in the Bankruptcy Code, when another more detailed provision grants comparable relief, any authority to issue the order under § 105(a) is *displaced*. Thus, to illustrate, the Sixth Circuit has ruled that bankruptcy courts may not use § 105(a) to compel an *unsecured* creditor to reimburse a trustee for certain expenses because § 506(c) expressly permits a trustee to recover the same expenses from *secured* creditors and does not mention unsecured parties.[638]

The "displacement" theory is not universally accepted. For example, § 523(a)(8) provides that certain student loans generally are not dischargeable.[639] The statute creates an exception where mandating repayment "would impose an undue hardship on the debtor and the debtor's dependents."[640] When that circumstance obtains, student loans are *fully* dischargeable. Despite the all-or-nothing language of § 523(a)(8), a substantial number of courts have ruled that they may employ § 105(a) to *partially*

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634 Id. at 626; *see also* § 524(a)(2) ("discharge in a case under this title . . . operates as an *injunction*") (emphasis added).

635 *Am. Hardwoods*, 885 F.2d at 626 (emphasis added).

636 *But cf.* Boyle, *supra* note 27, at 428–29, 437 (generally adopting the Ninth Circuit's argument).

637 *In re* Fesco Plastics, Inc., 996 F.2d 152, 154 (7th Cir. 1993).

638 Architectural Bldg. Components v. McClarty (*In re* Foremost Mfg. Co.), 137 F.3d 919, 924–25 (6th Cir. 1998); *see also* Bird v. Carl's Grocery Co. (*In re* NWFX, Inc.), 864 F.2d 593, 595–96 (8th Cir. 1989) (holding that bankruptcy courts may not use § 105(a) to "enlarge[] the right of setoff beyond that allowed in [11 U.S.C. § 553 (2000)] because such relief is not consistent with the provisions of the Code"). For an example of an "express," as opposed to a "displacement," type of conflict, see *In re* Unitcast, Inc., 214 B.R. 1010, 1018 (Bankr. N.D. Ohio 1997) (a bankruptcy court may not employ § 105(a) to alter the priority of claims as set forth in § 726(b)), *aff'd*, 219 B.R. 741 (6th Cir. B.A.P. 1998).

639 § 523(a)(8).

640 *Id.*

discharge student debts.[641] These courts apparently do not believe that § 523(a)(8) displaces their equitable powers.

This debate is moot for our purposes because the critical first step in the § 524(a) argument in *American Hardwoods* is erroneous: a non-debtor release is *not* a discharge. "Discharge" is a term of art under the Bankruptcy Code.[642] As the Ninth Circuit itself has recognized, a bankruptcy discharge extinguishes *all* of a debtor's liabilities, with limited exceptions.[643] Under § 1141(d)(1), "Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan . . . discharges the debtor from *any* debt that arose before the date of such confirmation."[644] Most non-debtor releases, however, only extinguish *selected* claims against the benefiting party.[645] As the Second Circuit explained in *Johns-Manville*, releases of individual claims do "not offer the umbrella protection of a discharge in bankruptcy."[646] Only where a third-party release purports to eliminate all, or substantially all, of the third party's debts—i.e., where the third party is receiving a full "non-debtor discharge"—does the release plausibly constitute a bankruptcy discharge, and thus fall within the scope of § 524(a) (and § 1141(d)(1)).[647] Moreover, non-debtor releases may only enjoin claims that are otherwise entitled to full payment under the debtor's plan of reorganization.[648] Discharges, however, may bar recovery on claims for which

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641 *See, e.g.*, Kapinos v. Graduate Loan Ctr. (*In re* Kapinos), 243 B.R. 271, 276–77 (W.D. Va. 2000) (contending that a "majority of courts have held that bankruptcy courts are empowered to partially discharge a debtor's student loans by virtue of 11 U.S.C. § 105," even though 11 U.S.C. § 523(a)(8) only provides for the *complete* discharge of such debts).

642 Wainer v. A.J. Equities, Ltd., 984 F.2d 679, 684 (5th Cir. 1993).

643 Lewis v. Scott (*In re* Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996); *accord In re* Collins, 173 F.3d 924, 930 (4th Cir. 1999).

644 § 1141(d)(1) (emphasis added).

645 *See supra* notes 44–48, 194, 298, 320, and accompanying text.

646 MacArthur v. Johns-Manville (*In re* Johns-Manville Corp.), 837 F.2d 89, 91 (2d Cir. 1988) (holding that an insurance third-party release was valid because it only prohibited certain lawsuits and did "not offer the umbrella protection of a discharge in bankruptcy"); *see also* Brubaker, *supra* note 27, at 995 ("Of course, the 'discharge' effected by a non-debtor release is only a partial discharge, and not nearly as broad and all-encompassing as that available through an actual bankruptcy filing.").

647 *But see In re* Dow Corning Corp., 198 B.R. 214, 243 n.22 (Bankr. E.D. Mich. 1996) (contending that there was no substantive difference between an insurance company "release" and a "discharge" and that "[q]uibbling over the terminology is unproductive"); *cf. In re* Arrowmill Dev. Corp., 211 B.R. 497, 503 (Bankr. D.N.J. 1997) ("A discharge in bankruptcy is an involuntary *release* by operation of law of creditor claims against an entity . . . .") (emphasis added); *In re* Dow Corning Corp., 255 B.R. 445, 476 (E.D. Mich. 2000) (same) (but still approving of the non-debtor release at issue), *rev'd on other grounds*, 280 F.3d 648 (6th Cir. 2002); Starr, *supra* note 27, at 487 (same).

648 *See supra* notes 348–51 and accompanying text.

the creditor will never receive payment in full.[649] In sum, because non-debtor releases and discharges are distinguishable, §§ 524(a) and 1141(d)(1) do not displace the authority to grant releases under §§ 105(a) and 1123(b)(6).

C. Energy Resources *and Conflicts Between Equitable Orders and Nonbankruptcy Law*

In *Energy Resources*, the Supreme Court explained that "[e]ven if consistent with the Code . . . a bankruptcy court 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."[650] The Court thus addressed whether tax allocation orders contravene § 6672 of the Internal Revenue Code.[651] Even though the High Court held that no discord exists between that statute and a designation order,[652] the opinion raises an important question—to what extent may bankruptcy courts use their equitable power to override nonbankruptcy law? This inquiry is highly pertinent to the validity of third-party releases because such releases eliminate liability that non-debtors would otherwise face under federal and state law.[653]

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649 *See* Ian Dattner, *Chapter 11 Protection: Whom Are We Protecting?*, 38 COLUM. J.L. & SOC. PROBS. 287, 292 (2005) ("A reorganization plan need not pay all creditors in full. In fact, because most companies entering Chapter 11 are insolvent, creditors rarely receive full dollar value.").

650 United States v. Energy Res. Co., 495 U.S. 545, 550 (1990).

651 *Id.* at 550–51.

652 *Id.* at 551.

653 *See* Brubaker, *supra* note 27, at 1017 n.209 ("[S]upplementary implementation sections such as § 1123(b)(6) merely beg the question whether non-debtor releases are in fact 'appropriate' provisions of a plan. That question inevitably requires consideration of the fact that non-debtor releases directly contravene nonbankruptcy law that would impose liability on the released non-debtors.") (immediately thereafter quoting the same passage from *Energy Res.*, 495 U.S. at 551, that I quoted in the text at the beginning of the paragraph); *see also id.* at 1010 ("Implicit in the idea that a non-debtor release is appropriate where necessary to the debtor's successful reorganization is the assumption that the reorganization policy is supreme, and in furtherance thereof, a bankruptcy judge can unilaterally override legitimate policies embodied in nonbankruptcy law that would place liability upon the released non-debtors."). Even channeling releases, which provide the creditor with payment in full, are inconsistent with nonbankruptcy law. First, in the absence of a release (or a provisional injunction), nonbankruptcy law would permit the creditor to recover from the non-debtor *at the latest* upon confirmation of the chapter 11 plan and the lifting of any non-debtor *stay*. *See* Meltzer, *supra* note 27, at 26 n.83 (observing that channeling releases in plans that provide payment in full over time precludes a claimant "from recovering on its claim from source that could afford to pay it immediately"). Second, if the debtor defaults on its plan obligations, a not atypical occurrence, the creditor is denied the promised full recovery. *See supra,* Part III.C.; *see also* Brubaker, *supra* note 27, at 1029:

> In many cases, of course, non-debtor liability law and policy assumes its greatest significance in precisely the context in which non-debtor releases are approved; nonbankruptcy law gives the creditor another source of recovery in the event the debtor is unable to fully pay the creditor because of financial difficulties. Thus, the propriety of a necessary non-debtor release directly

It is critical to note, first, what is *not* at issue. There is little doubt that § 105(a) orders enforcing more specific provisions of the Bankruptcy Code may override nonbankruptcy law. Because such "tethered" orders are merely implementing other enactments, the bankruptcy statute being enforced is the one prevailing over contrary federal or state law, not § 105(a). For example, a bankruptcy court may grant a § 105(a) injunction barring a creditor from attempting to enforce its interest in estate property sold "free and clear" pursuant to § 363(f) of the Code.[654] In that circumstance, state law governing the creditor's interest is really trumped by § 363(f) rather than § 105(a).[655] And there is no question that express dictates in the Bankruptcy Code like § 363(f) prevail over nonbankruptcy rights.[656] Properly understood, then, the issue is this: may *untethered* § 105(a) orders—orders implementing general bankruptcy policies—override nonbankruptcy law? Not surprisingly, the authorities are split on this issue.

Numerous decisions hold that bankruptcy courts may not use their general equitable powers to modify nonbankruptcy rights.[657] This proposition is often

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> pits the reorganization policy against these legitimate nonbankruptcy policies underlying non-debtor liability.

But see In re Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 666–67, 686 (Bankr. D.D.C. 1992) (holding that a non-debtor release that extinguished the contribution claims that partners, who did not contribute assets to the estate, could assert against contributing partners, was not inconsistent with state law).

[654] *See* 11 U.S.C. § 363(f) (2000); *supra* notes 132–33, 228–33, and accompanying text.

[655] *See* P.K.R. Convalescent Ctrs., Inc. v. Virginia (*In re* P.K.R. Convalescent Ctrs., Inc.), 189 B.R. 90, 96 (Bankr. E.D. Va. 1995) ("Based on the conflict between 11 U.S.C. § 363(f) and [Virginia law], the court will exercise its equitable power [under § 105(a)] and award the injunction.") (issuing an injunction prohibiting "any act to collect an interest in the bankruptcy estate in contravention of a court order to sell the property free and clear . . . under § 363(f)(5)"); *see also In re* Jaras International, Inc., 81 B.R. 715, 718 (Bankr. S.D. Fla. 1987) (holding that § 105(a) permitted the court to modify an attorney's state law retaining lien where the possessory rights created by the lien conflicted with the court's § 542(e) power to order a debtor's attorney to produce information and records).

[656] *See* Butner v. United States, 440 U.S. 48, 54 n.9 (1979) ("[I]t has been settled from an early date that state laws to the extent that they conflict with the laws of Congress, enacted under its constitutional authority, on the subject of bankruptcies are suspended."); Johnson v. First Nat'l. Bank of Montevideo, 719 F.2d 270, 273 (8th Cir. 1983) ("Article I, section 8 of the United States Constitution provides that Congress shall have the power to establish uniform bankruptcy laws throughout the United States. Where Congress has chosen to exercise its authority, contrary provisions of state law must accordingly give way."); *In re* Roach, 824 F.2d 1370, 1373 (3d Cir. 1987) (same); *see also* Noonan v. Sec'y of Health and Human Servs. (*In re* Ludlow Hosp. Soc., Inc.), 124 F.3d 22, 28 (1st Cir. 1997) ("Congress quite obviously intended to invest debtor estates and their representatives with certain rights, some of which *may augment* prepetition rights possessed by the debtor under nonbankruptcy law.").

[657] *See, e.g.*, Unsecured Creditors' Comm. v. Highland Superstores, Inc. (*In re* Highland Superstores, Inc.), 154 F.3d 573, 578–79 (6th Cir. 1998) ("Bankruptcy courts simply do not have free rein to ignore a statute in the exercise of their equitable powers pursuant to 11 U.S.C. § 105."); Noonan v. Sec'y of Health and Human Servs. (*In re* Ludlow Hosp. Soc., Inc.), 124 F.3d 22, 27 (1st Cir. 1997) ("Bankruptcy Code § 105(a)

justified by reference to *Butner v. United States*,[658] where the Supreme Court explained that state law governs the establishment of property rights in bankruptcy absent clear preemption by a federal bankruptcy statute.[659] Courts adopting this "restrictive" understanding have denied requests made under § 105(a) to create or alter liens,[660] to discount damages for breach of contract

may not be invoked to alter substantive debtor rights defined under the applicable nonbankruptcy law."); Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1311 (1st Cir. 1993) ("Nor does section 105(a) authorize courts . . . to expand the contractual obligations of the parties."); Forlini v. Northwest Savings, F.A., 200 B.R. 9, 12 (D.R.I. 1996) (§ 105(a) does not grant bankruptcy courts "'*carte blanch*'" to alter the contractual duties or override state and federal statutes); Willcox v. Stroup (*In re* Willcox), 329 B.R. 554, 579 (Bankr. D.S.C. 2005) ("[T]his Court cannot use equity to create new substantive rights or to override the provisions of state law."); *In re* Brick Hearth Pizza, Inc., 302 B.R. 877, 881 (Bankr. D. Minn. 2003) ("[T]he 'equity power' under 11 U.S.C. § 105(a) cannot be applied to circumvent unequivocal provisions of substantive law, including relevant state law that is not expressly superseded by the Bankruptcy Code."); *In re* Sendmygift.com, Inc., 280 B.R. 667, 679 (Bankr. D. Minn. 2002) ("'Equity,' in its general sense, cannot lie in a bankruptcy case to override an explicit requirement of nonbankruptcy law that governs the validity of a claim."); Prudential Ins. Co. of America v. Three Flint Hill Ltd. P'ship (*In re* Three Flint Hill Ltd. P'ship), 202 B.R. 706, 712 (Bankr. D. Md. 1995) ("Neither does § 105(a) empower the bankruptcy court to override state law."), *subsequently affirmed*, 103 F.3d 120 (4th Cir. 1996); 641 Assocs., Ltd. v. Balcor Real Estate Fin., Inc. (*In re* 641 Assocs., Ltd.), Bankr. No. 91-11234S, Adv. Nos. 93-0363S, 93-0456S, 1993 WL 332646, at *8 (Bankr. E.D. Pa. Aug. 26, 1993) ("There is no provision in the Bankruptcy Code allowing a bankruptcy court to disregard state-law contractual rights."); Amatex Corp. v. Aetna Cas. & Sur. Co. (*In re* Amatex Corp.), 97 B.R. 220, 226 (Bankr. E.D. Pa. 1989) ("[T]his court is not authorized, pursuant to § 105(a), or any other authority, to disregard established state law principles in providing relief to the Debtor."); *see also* 2 COLLIER ON BANKRUPTCY ¶ 105.01[2], at 105-7 to 105-8 (Lawrence P. King ed., 15th ed. rev. 2004) (contending that § 105(a) "does not allow the bankruptcy court to override . . . mandates of other state and federal statutes").

[658] 440 U.S. 48 (1979). For decisions from the previous footnote relying upon *Butner* in reaching their conclusion regarding the relationship of § 105(a) and nonbankruptcy law, see Unsecured Creditors' Comm. v. Highland Superstores, Inc. (*In re* Highland Superstores, Inc.), 154 F.3d 573, 578 (6th Cir. 1998) (quoting *Butner*, 440 U.S. at 54); Prudential Ins. Co. of America v. Three Flint Hill Ltd. P'ship (*In re* Three Flint Hill Ltd. P'ship), 202 B.R. 706, 709 (Bankr. D. Md. 1995) (quoting *Butner*, 440 U.S. at 56), *subsequently affirmed*, 103 F.3d 120 (4th Cir. 1996); Amatex Corp. v. Aetna Cas. & Sur. Co. (*In re* Amatex Corp.), 97 B.R. 220, 225 (Bankr. E.D. Pa. 1989) (citing *Butner*, 440 U.S. at 55–56).

[659] *Butner*, 440 U.S. at 54 n.9 ("[S]tate laws are . . . suspended only to the extent of actual conflict with the system provided by the Bankruptcy Act of Congress.") (decided under the Bankruptcy Act); *id.* at 55 ("Property interests are created and defined by state law."); *accord* Vanston Bondholders Protective Comm. v. Greene, 329 U.S. 156, 161 (1946) ("What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition is filed, is a question which, in the absence of overruling federal law, is to be determined by reference to state law."); Johnson v. First Nat'l. Bank of Montevideo, 719 F.2d 270, 273–74 (8th Cir. 1983) ("It is equally well-settled, however, that state laws are suspended only to the extent of actual conflict with the bankruptcy system provided by Congress, so that in the absence of any conflict between the state and bankruptcy laws, the law of the state where the property is situated governs questions of property rights.") (subsequently citing and quoting *Butner*, 440 U.S. at 55); *In re* Kennedy, 158 B.R. 589, 597 (Bankr. D.N.J. 1993) ("[S]tate law rights must prevail absent specific and clearly expressed congressional intention to preempt state law.").

[660] *See In re* Brick Hearth Pizza, Inc., 302 B.R. 877, 880–81 (Bankr. D. Minn. 2003) (holding that the court could not use § 105(a) to grant a lawyer-creditor the equivalent of a lien on the retainer paid by the

based on the debtor's creditworthiness,[661] to mandate payment under an insurance policy before the duty to pay arises,[662] or to extend the life of expired contracts.[663] Perhaps most poignantly, one court recently ruled that § 105(a) does not permit the allocation of tax *over*payments because, unlike in *Energy Resources*, a federal statute expressly grants the IRS the right to designate the liabilities to which such payments apply.[664]

Other authorities, however, indicate that nonbankruptcy law is not an absolute bar to the exercise of equitable power. Besides granting third-party releases,[665] courts embracing this "permissive" approach have used § 105(a) to override federal and state law by disallowing punitive damages claims,[666]

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debtor-client because the creditor did not have an actual lien on the retainer under Minnesota law) ("[T]he Bankruptcy Court cannot invoke § 105 to create some sort of '*de facto* priority claim' in the nature of a first and preemptive call on the specific asset of a retainer deposit."); Prudential Ins. Co. of America v. Three Flint Hill Ltd. P'ship (*In re* Three Flint Hill Ltd. P'ship), 202 B.R. 706, 709, 712 (Bankr. D. Md. 1995) (holding that the court could not employ § 105(a) to expand the scope of a creditor's lien to property free of the lien under state law), *subsequently affirmed*, 103 F.3d 120 (4th Cir. 1996).

661 Unsecured Creditors' Comm. v. Highland Superstores, Inc. (*In re* Highland Superstores, Inc.), 154 F.3d 573, 578–80 (6th Cir. 1998).

662 Amatex Corp. v. Aetna Cas. & Sur. Co. (*In re* Amatex Corp.), 97 B.R. 220, 225–26 (Bankr. E.D. Pa. 1989) (holding that the court could not use § 105(a) to compel the debtor's insurers to pay their complete coverage liability prior to the debtor becoming legally liable for that amount because such an order would "fly directly in the face of very basic tenets of Pennsylvania insurance law").

663 P & J Marketing, Inc. v. Old Chepachet Village, Inc. (*In re* P & J Marketing, Inc.), 142 B.R. 608, 610–11 (Bankr. D.R.I. 1992) (holding that § 105(a) did not permit the court to renew an expired option to buy contained in the debtor's lease); 2 COLLIER ON BANKRUPTCY ¶ 105.05 (Lawrence P. King ed., 15th ed. rev. 2005) ("[S]ection 105 does not allow the bankruptcy court to breath life into contractual agreements that have expired by their own terms.") (collecting authorities). More important than any conflict with state law, however, forcing a party to renew its agreement with the debtor may violate the Constitution. *See, e.g.*, U.S. CONST. amend. V ("nor shall any person be . . . deprived of life, liberty or property without due process of law; nor shall private property be taken for public use, without just compensation").

664 *In re* Lybrand, 338 B.R. 402, 406–07 (Bankr. W.D. Ark. 2006) ("The most significant distinction between *Energy Resources* and this case is that *Energy Resources* did not involve the allocation of a refund, which is governed by a specific statute, 26 U.S.C. § 6402(a)(2000)."). Section 6402(a) provides that in "the case of any overpayment, the Secretary . . . may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment . . . ." 26 U.S.C. § 6402(c) (2000).

665 In Butner v. United States, 440 U.S. 48 (1979), the High Court stated that "[u]nless some *federal* interest requires a different result, there is no reason why [property interests] should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 55 (emphasis added). At least one pro-release court relied upon this language to distinguish the case. *See In re* Heron, Burchette, Ruckert & Rothwell, 148 B.R. 660, 685–86 (Bankr. D.D.C. 1992) (distinguishing *Butner* because the third-party release in the debtor's plan was the only way to serve "the *federal* interests underlying chapter 11") (emphasis added).

666 *See, e.g.*, *In re* A.H. Robins Co., 89 B.R. 555, 562 (E.D. Va. 1988) ("Equity provides this Court the power to disallow punitive damages if the Court determines that such an allowance would frustrate the successful reorganization of the company. It is this Court's finding that punitive damages must be disallowed

partially discharging student debts,[667] modifying the scope of liens,[668] and, notably, allocating tax overpayments despite the existence of the statute granting that right to the IRS.[669]

The language of *Energy Resources* supports the permissive understanding. There, the Supreme Court stated that "a bankruptcy court 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*."[670] The phrase "*might* be inappropriate" strongly intimates that contravention of nonbankruptcy law is merely a *factor* bankruptcy judges must consider in deciding whether to grant relief under the equitable statutes. Accordingly, §§ 105(a) and 1123(b)(6) permit orders that override federal or state law if the bankruptcy court determines, "in the exercise of [its] *discretion*,"[671] that the interests underlying the order outweigh the policies served by conflicting law.[672]

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if Robins is to be given the opportunity provided under Chapter 11 to successfully reorganize and function as a viable entity."); *In re* Apex Oil Co., 118 B.R. 683, 699–700 (Bankr. E.D. Mo. 1990) ("[I]t is well-accepted that the Court has the inherent equitable power to disallow, limit, or subordinate Claims for punitive or exemplary damages or fines, penalties, or forfeitures.") (disallowing virtually all claims for punitive and exemplary damages, fines, penalties, and forfeitures where such relief was necessary to the success of the debtor's reorganization).

667 *See, e.g.*, Kapinos v. Graduate Loan Ctr. (*In re* Kapinos), 243 B.R. 271, 276–77 (W.D. Va. 2000) (contending that a "majority of courts have held that bankruptcy courts are empowered to partially discharge a debtor's student loans by virtue of 11 U.S.C. § 105," even though 11 U.S.C. § 523(a)(8) only provides for the *complete* discharge of such debts, and quoting United States v. Energy Res. Co., 495 U.S. 545, 549 (1990), in support of the decision to follow those courts).

668 *See* C & C Company v. Seattle-First Nat'l Bank (*In re* Coal-X-Ltd., "76"), 103 B.R. 276, 279–80 (D. Utah 1986) (expressly overriding state law via § 105(a) by reducing the "value and extent" of a creditor's lien in order to "effect a fair and equitable distribution of the estate's limited assets").

669 *In re* Moore, 200 B.R. 687, 687, 690–91 (Bankr. D. Or. 1996) (holding that, under United States v. Energy Res. Co., 495 U.S. 545 (1990), § 105(a) permitted the court to allocate a tax overpayment to the IRS's priority claims rather than the agency's general unsecured claims because it was necessary to the debtor's reorganization, even though the IRS would receive no distribution otherwise on its non-priority claim). *See generally* § 6402(a) (granting the IRS the right to allocate tax overpayments).

670 United States v. Energy Res. Co., 495 U.S. 545, 550 (1990) (emphasis added).

671 *Id.* (emphasis added).

672 *Id.*; *see also* IRS v. Energy Res. Co. (*In re* Energy Res. Co.), 871 F.2d 223, 234 (1st Cir. 1989) ("[U]pon consideration of the reorganization plan as a whole, in so far as the particular structure or allocation of payments increases the risk that the IRS may not collect the total tax debt, is that risk nonetheless justified by an offsetting increased likelihood of rehabilitations, i.e., increased likelihood of payment to creditors who might otherwise lose their money."), *aff'd*, 495 U.S. 545 (1990). *But see* Brubaker, *supra* note 27, at 1030–33 (arguing that bankruptcy courts are incapable of determining, on a case-by-case basis, whether the benefits of a reorganization "are more important than the indirect benefits produced by non-debtor liability").

The *Energy Resources* Court also explained that §§ 105(a) and 1123(b)(6) "are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to *modify* creditor-debtor relationships." 495 U.S. at 549 (emphasis added). "Modifying" a creditor-debtor relationship *might* involve altering the nonbankruptcy rights of the parties. But the cases cited by the Supreme Court in support

Of course, there are important limits on the use of equitable power to trump nonbankruptcy law. As the High Court more recently explained in *Raleigh v. Illinois Department of Revenue*,[673] bankruptcy courts "are not authorized in the name of equity to make *wholesale* substitution of underlying law controlling the validity of creditors' entitlements, but are limited to what the Bankruptcy Code itself provides."[674] In other words, bankruptcy courts may not, "as a matter of course," substitute equitable principles for governing substantive law.[675] Where "extraordinary circumstances" are present, however, even some decisions in the restrictive line of authority acknowledge that the bankruptcy court's equitable powers may override nonbankruptcy rights.[676] And, as noted above, "extraordinary" or "unusual" circumstances are the only ones in which most pro-release courts, and this Article, contend that non-debtor releases are permissible.[677] Indeed, even when all of the elements of the *Master Mortgage* test—or my amended version—are satisfied, the granting of a release is not automatic; the court must still exercise its discretion and decide, in the *particular* case, whether the release is warranted, all factors considered.[678] Thus, a court might conclude that a release satisfying *Master Mortgage* should not issue because the interests underlying nonbankruptcy law trump the reorganization policy in that action.

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of the quoted language suggest a narrower interpretation. *See, e.g.*, Pepper v. Litton, 308 U.S. 295, 303–11 (1939) (identifying various examples of the use of bankruptcy equitable power, all of which appear to be consistent with nonbankruptcy law).

[673] 530 U.S. 15 (2000).

[674] *Id.* at 24; *see also In re* Sendmygift.com, Inc., 280 B.R. 667, 679 (Bankr. D. Minn. 2002) (citing *Raleigh*, 530 U.S. at 15, among other authorities, for the proposition that "'[e]quity, in a general sense, cannot lie in a bankruptcy case to override an explicit requirement of substantive nonbankruptcy law that governs the validity of a claim."); *cf.* United States v. Noland, 517 U.S. 535, 536, 540–41 (1996) (holding that bankruptcy courts may use their powers of equitable subordination under § 510(c) to subordinate claims based on the facts of a particular case, but may not create categorical rules of subordination in derogation of the priority scheme set forth in the Bankruptcy Code); *accord* United States v. Reorganized CF & I Fabricators of Utah, Inc., 518 U.S. 213, 216, 228–29 (1996) (following *Noland*).

[675] Johnson v. First Nat'l. Bank of Montevideo, 719 F.2d 270, 274 (8th Cir. 1983) ("[T]o hold that a bankruptcy court may, *as a matter of course*, suspend the running of a statutory period of redemption pursuant to § 105(a), would be to enlarge the debtor's property rights beyond those specifically set forth by the Minnesota legislature and by Congress in § 108(b).") (emphasis added).

[676] *See, e.g.*, Johnson v. First Nat'l. Bank of Montevideo, 719 F.2d 270, 274 (8th Cir. 1983) ("From the fundamental principles embraced by the *Butner* opinion, however, as well as from the language of § 105(a) itself, it follows that, absent a specific grant of authority from Congress *or exceptional circumstances*, a bankruptcy court may not exercise its equitable powers to create substantive rights which do not exist under state law."); Federal Land Bank of Louisville v. Glenn (*In re* Glenn), 760 F.2d 1428, 1440 (6th Cir. 1985) (quoting the language in the previous parenthetical from *Johnson*, 719 F.2d at 274); .

[677] *See supra* notes 303–04, 322–23, and accompanying text.

[678] *See supra* notes 358–59 and accompanying text.

CONCLUSION

This Article contends that *Energy Resources* vindicates the pro-release position on every major issue concerning the validity of non-debtor releases. Therefore, under existing precedent, bankruptcy courts possess the equitable power to extinguish claims against third parties. While *Energy Resources* resolves the *legal* dispute, a broader question remains—are non-debtor releases justified on policy grounds? *Should* courts have the legal authority to grant this type of relief? While the policy debate is generally beyond the scope of my undertaking here, certain aspects of it are worth brief consideration.

Beginning with some pro-release observations, as indicated above, many courts believe that a third-party release can be essential to a debtor's reorganization.[679] Without this relief, for example, corporate insiders might refuse to contribute funds or time to the debtor's plan, making continued operations impossible.[680] Since promotion of reorganizations is the central policy of chapter 11, releases may be defended on the ground that they serve this cardinal goal. In addition, by consolidating adjudication of related claims into a single forum, non-debtor releases "can eliminate piecemeal litigation and curb costs significantly."[681] They might also bring "global peace" to mass tort disputes and allow for timely payments to thousands of injured parties. In short, as one commentator concluded, permitting non-debtor releases gives courts the "flexibility to act in the best interests of all parties concerned."[682]

Turning to the anti-release position, the availability of provisional injunctions casts doubt on the "necessity" of many non-debtor releases. A provisional injunction provides substantially similar relief, but places the risk of plan failure on the benefiting third party. Of course, the non-debtor may hold out for a release to guarantee its future security. But the cases in which a provisional injunction will not suffice should be few and far between. Consistent with this analysis, Professor Brubaker contends that non-debtor releases are seldom necessary to the debtor's reorganization.[683] Such relief is more likely to serve as a form of costless compensation to the third party than

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679 *See, e.g.*, *supra* notes 291–92, 298, and accompanying text.

680 *See* NAT'L BANKR. REVIEW COMM'N, *supra* note 32, at 534–35; *see also* Boyle, *supra* note 27, at 422 (suggesting that non-debtor releases may be necessary to "ensure cooperation" of third parties or "generate non-debtor contributions to the reorganization that the non-debtor otherwise would not have made").

681 NAT'L BANKR. REVIEW COMM'N., *supra* note 32, at 535.

682 Inman, *supra* note 27, at 648

683 Brubaker, *supra* note 27, at 1021.

as an incentive for funding required to prevent the debtor's liquidation.[684] Indeed, Judith Starr hypothesizes that permitting non-debtor releases creates an incentive for managers to move troubled corporations into bankruptcy where the plan of reorganization might extinguish their personal liabilities.[685] Professor Brubaker also asserts that it "is nearly impossible to verify *or* disprove in any reliable manner" whether a particular release will mean the difference between a successful reorganization and termination of the debtor's business.[686] And even if such a determination were feasible, he continues, bankruptcy courts are ill-suited to weighing the benefits of a successful reorganization against the burdens imposed by vitiating nonbankruptcy rights through the release.[687] Finally, Peter Boyle suggests that third-party releases may undermine the "integrity of guaranties," which could impact the cost of financing,[688] and limit the usefulness of joint and several liability.[689] Perhaps it was such observations that ultimately convinced the National Bankruptcy Review Commission to counsel that Congress amend the Code to permit only voluntary releases.[690]

It is difficult to assess these policy arguments. Few, other than Professor Brubaker's, have been substantially developed. What is needed at this stage is greater investigation into the empirical details. Whatever the result of that inquiry, the final decision should be made by Congress. Non-debtor releases, even of the channeling variety, are a drastic form of relief. They implicate clashes between critical policies underlying the Bankruptcy Code and other federal and state law. The availability of such relief is an issue best resolved by a legislative body after diligent consideration of the countervailing values.

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[684] *Id.* at 1023–26.

[685] Starr, *supra* note 27, at 486 ("Moreover, giving insiders the ability to force a settlement on unwilling creditors, without requiring them to take on the burdens associated with filing for bankruptcy, creates a moral hazard for insiders of troubled companies."). *But see* Inman, *supra* note 27, at 648 (anti-release authorities have "not . . . sufficiently argued . . . that to give courts the power to permanently enjoin suits against non-debtors will provide a mechanism of escape for nondebtors and unfairly prejudice claimants").

[686] Brubaker, *supra* note 27, at 1027 & n.48.

[687] *Id.* at 1030–32.

[688] Boyle, *supra* note 27, at 422, 443.

[689] *Id.* at 444.

[690] *See* NAT'L BANKR. REVIEW COMM'N, *supra* note 32, at 538 ("[T]he Commission's Recommendation would permit only voluntary releases."); *see also id.* at 534 ("Congress should amend sections 1123 and 524(e) to clarify that it is within the discretion of the court to allow a plan proponent to solicit release of nondebtor liabilities. Creditors that agree in a separate document to release nondebtor parties will be bound by such releases, whereas creditors that decline to release their claims against nondebtor parties will not be bound to release their claims.").