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Delaware Bankruptcy Court Affirms Its Constitutional Authority to Approve Nonconsensual Releases

Some six years after the United States Supreme Court decided *Stern* v. *Marshall*, courts continue to grapple with the decision's meaning and how much it curtails the exercise of bankruptcy court jurisdiction.[1] The U.S. Bankruptcy Court for the District of Delaware recently addressed a lingering *Stern* question: can bankruptcy courts constitutionally approve, by a final order, a nonconsensual third party release of non-bankruptcy claims in connection with plan confirmation? In a 69-page decision issued on October 3, 2017, Judge Laurie Selber Silverstein ruled that they can.[2]

Background

On November 10, 2015, Millennium Lab Holdings II, LLC and certain of its affiliates filed for chapter 11 with a prepackaged plan of reorganization. Under the plan, certain non-debtor equity holders of Millennium would contribute $325 million for a release of certain claims, including claims held by Millennium's creditors, as part of a larger settlement. On December 9, 2015, a Millennium senior secured lender, Voya Financial, Inc., objected to the plan's release of claims against the contributing shareholders. Voya argued principally that (1) the bankruptcy court did not have subject matter jurisdiction to approve the nonconsensual third party releases and (2) section 105 of the Bankruptcy Code does not authorize bankruptcy courts to grant nonconsensual third party releases. Voya also filed a complaint in the Delaware District Court asserting RICO and common law fraud claims against the equity holders.

In December 2015, Judge Silverstein confirmed the Millennium plan over Voya's objection. She concluded that, at a minimum, she had "related to jurisdiction" over the released claims and that the releases met the Third Circuit standard for such releases. Voya appealed from the confirmation order, challenging the exercise of "related to" jurisdiction over a non-debtor's direct claims against other non-debtors for fraud and other willful misconduct and questioning whether the bankruptcy court has the constitutional authority to release such claims without the consent of the releasing non-debtor.[3]

In March 2017, the District Court remanded the case to the Bankruptcy Court to consider the question of its constitutional authority to approve the nonconsensual release of the claims against the shareholders.

[1] *Stern* v. *Marshall*, 131 S. Ct. 2594 (2011).

[2] *See In re Millennium Lab Holdings II, LLC*, No. 15-12284, 2017 WL 4417562 (Bankr. D. Del. Oct. 3, 2017).

[3] Voya filed an emergency motion seeking direct certification of its appeal to the Third Circuit. Judge Silverstein granted the request, but the Third Circuit denied the petition. The appeal proceeded before the District Court.

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The District Court observed that "the Bankruptcy Court had no occasion to explain its reasoning on this issue."

The Bankruptcy Court's Decision

Judge Silverstein first reviewed the statutory basis for exercising bankruptcy court jurisdiction. Section 157(b)(2) of Title 28 of the United States Code enumerates sixteen examples of "core proceedings" (proceedings in which the bankruptcy court can render a final judgment, as contrasted with non-core proceedings that merely "relate to" a bankruptcy case). "Confirmation of plans" is listed as a core proceeding and so, she concluded, a statutory basis for jurisdiction existed.[4]

She next considered case law concerning the scope of the bankruptcy court's constitutional adjudicatory authority, focusing on *Northern Pipeline Construction Co.* v. *Marathon Pipe Line Co.*,[5] *Stern*, and their progeny. Judge Silverstein noted that in *Stern*, the Supreme Court had announced a disjunctive test for determining a bankruptcy court's ability to enter a final order. The elements of the disjunctive test include "whether the action at issue arises from the bankruptcy itself or would necessarily be resolved in the claims allowance process."[6] She maintained that the outcome in *Stern* – "that a bankruptcy court cannot enter a final order on a trustee's state law counterclaim against a creditor that is not resolved in the process of ruling on the creditor's proof of claim – tread little new ground" and that the ruling itself was narrow.[7] Judge Silverstein noted that the parties found two post-*Stern* decisions addressing the constitutionality of bankruptcy court judges entering final orders confirming plans with third party releases.[8] In both, the judges concluded that they had such authority because the question arose in the context of plan confirmation and pertained to a debtor's rights under the Bankruptcy Code.[9]

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4 With certain exceptions not relevant here, the U.S. district courts have "original and exclusive" jurisdiction of all cases under the Bankruptcy Code. 28 U.S.C. § 1334(a). They may refer such proceedings to the bankruptcy judges in their districts, 28 U.S.C. § 157(a), and have done so pursuant to a standing order of referral. As noted above, the extent to which a bankruptcy judge can finally decide a referred matter depends on whether it is a "core" or "noncore" proceeding. 28 U.S.C. § 157(b), (c).

5 458 U.S. 50 (1982).

6 *Stern*, 131 S. Ct. at 2618.

7 *Millennium*, 2017 WL 4417562, at *11. Judge Silverstein noted that "the Supreme Court did not find the entirety of Congress's referral of core proceedings to bankruptcy judges to be unconstitutional . . . the *Stern* court dealt with [one instance of constitutional infirmity]; it did not expand its holding to the entirety of § 157(b)(2)."

8 *See In re Charles St. African Methodist Episcopal Church of Boston*, 499 B.R. 66 (Bankr. D. Mass. 2013); *In re MPM Silicones, LLC*, No. 14-22503, 2014 WL 4436335, at *34 (Bankr. S.D.N.Y. Sept. 9, 2014).

9 *Charles St.*, 499 B.R. at 99 (finding that confirmation of a plan is a public right and not an adjudication of all the disputes it affects); *MPM*, 2014 WL 4436335, at *12 (holding that the bankruptcy court had jurisdiction to issue a final order with respect to a plan of reorganization containing releases).

Judge Silverstein did not end her analysis there. She next performed her own *Stern* analysis. After surveying interpretations of *Stern* elsewhere, Judge Silverstein held that bankruptcy courts have constitutional adjudicatory authority to make final determinations respecting nonconsensual third party plan releases under any interpretation of *Stern.* Her ruling turned in large part on her conclusion that plan confirmation was the operative proceeding for purposes of a *Stern* analysis – a proceeding she viewed as a matter within a bankruptcy court's core competency and one that depends on federal bankruptcy law.[10] She also determined that courts do not consider the merits of particular claims when assessing the permissibility of nonconsensual third party releases.[11]

Judge Silverstein then turned to Voya's arguments. She rejected Voya's assertion that she lacked constitutional adjudicatory authority to approve the nonconsensual releases because, the argument went, the claims did not "stem from the bankruptcy itself" and were not "resolvable in the claims allowance process." She observed that nothing in *Stern* or its progeny supported Voya's assertion that the operative proceeding for *Stern* purposes was the District Court action (rather than the plan confirmation proceeding) and that *Stern*'s disjunctive test applied to Voya's claims.[12]

Judge Silverstein also rejected Voya's argument that a bankruptcy court could not constitutionally enter a final order affecting a creditor's lawsuit against a third party. She noted that in the Third Circuit, *Stern* does not prevent a bankruptcy court from entering final orders in core proceedings, such as confirmation of a plan, notwithstanding the collateral effect on state law claims.[13] She concluded that there is "no question that . . . a bankruptcy judge may enter a final order in a core matter that impacts or even precludes a state law action between two non-debtors"[14] and observed that adopting Voya's arguments "would dramatically change the division of labor between the bankruptcy and district courts."[15]

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10 *Id.* at *14.

11 *Id.* at *16.

12 Judge Silverstein pointed out that had she imported the disjunctive test into the plan confirmation process, she would have concluded that both prongs were satisfied. Plan confirmation is the operative proceeding, and the releases are integral to confirmation and, thus, essential to the "restructuring of the debtor-creditor relationship." *Id.* at *18.

13 She also stated that the Third Circuit has "declared that claims arising under the federal bankruptcy laws are public rights" (which bankruptcy courts have statutory and constitutional authority to adjudicate). The bankruptcy court concluded that there is "no question that . . . a bankruptcy judge may enter a final order in a core matter that impacts or even precludes a state law action between two non-debtors." *Id.* at *20.

14 As for Voya's contention that third party releases are equivalent to an "impermissible adjudication," Judge Silverstein saw this position as a substantive argument against releases, not an argument for prohibiting a bankruptcy court from entering a final order confirming a plan and releasing third party claims. *Id.* at *23.

15 *Id.* at **26–27.

Judge Silverstein also found procedural infirmities in Voya's position.[16] She determined that even if she lacked the constitutional authority to enter a final order confirming the plan, Voya had forfeited and waived its right to challenge the Court's authority by failing to raise the issue at confirmation.

Conclusion

While *Millennium* is thoroughgoing in its analysis and instructive on the scope of a bankruptcy court's post-*Stern* constitutional authority – particularly in the context of plan confirmation – it will likely not be the last word on the subject. On October 16, 2017, Voya appealed Judge Silverstein's decision, now giving the District Court (and potentially the Third Circuit) an opportunity to weigh in.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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[16] The bankruptcy court found that Voya did not reserve its right to object to the Court's constitutional authority consistent with Local Rule 9013-1(h) because Voya failed to do so in its initial confirmation objection. To the extent Voya believed it made a constitutional adjudicatory authority argument in its initial confirmation objection, its failure to respond to the Debtors' constitutional arguments in its supplemental confirmation objection and during oral argument at confirmation constituted a waiver of the right to contest the bankruptcy court's constitutional authority. Moreover, to the extent Voya made a strategic decision to hold its constitutional authority argument in reserve for appeal and to seek direct certification to the Third Circuit, Judge Silverstein found that Voya waived its right to contest the Court's constitutional authority. *Id.* at *34.