By Robert M. Charles, Jr.

Eleventh Circuit Validates Plan Release of Claims Against Insurers

Although a discharge might not release third parties and protects only the debtor against a determination of personal liability, in *In re Le Centre on Fourth LLC*, the Eleventh Circuit recently validated plan provisions that barred a claimant from proceeding to obtain recovery from the debtor's and third parties' insurers after plan confirmation.[1] Because the plan provisions were mentioned in a disclosure statement and served on the claimant's counsel, who also had notice of the confirmation hearing, due process was satisfied, even though the scope of the plan release was expanded on the day of the confirmation hearing and the debtor ignored the notice of plan-injunction requirements of Rule 2002(c)(3) of the Federal Rules of Bankruptcy Procedure. The claimant's nominal claims against the debtor and third parties were barred, and the respective insurers avoided any liability without contributing to the plan.

Robert M. Charles, Jr.
Lewis Roca Rothgerber Christie LLP
Tucson, Ariz.

Rob Charles is a partner with Lewis Roca Rothgerber Christie LLP and teaches bankruptcy law at the University of Arizona James E. Rogers College of Law in Tucson, Ariz.

Claimant Injured and Allowed to Sue

Willie Jackson was a paraplegic in his wheelchair when he was hit by a hotel valet driver. Jackson sued the driver and valet company. The debtor, Le Centre on Fourth LLC, owned the hotel property. The debtor leased the hotel to an investor-owned entity, which engaged the debtor as manager. The debtor then hired an affiliate of the debtor's principals to operate the hotel. The debtor, management company and insider manager had indemnity rights among each other.

Jackson had a suit pending when the debtor filed its bankruptcy case. On Jackson's request, the bankruptcy court modified the stay to permit Jackson to assert and prosecute claims against the debtor solely to pursue insurance, while Jackson waived recourse against the debtor's estate. There was no nondebtor stay, and the personal-injury action proceeded outside of bankruptcy court.

Claimant Received Notice of Plan Provisions

In the bankruptcy case, the debtor offered a plan and disclosure statement, including the discharge and plan injunctions with a broad scope. The debtor would be protected by an injunction exceeding the scope of the discharge, as were the nondebtors — the investor-owned tenant and insider management company. The releases were not optional, failure to vote for the plan was deemed a release, and the reported opinions do not suggest that the creditors burdened by the releases were offered additional consideration, nor that the insurers contributed anything to the plan.

Jackson's counsel received copies of the plan and disclosure statement. On the day of the confirmation hearing, without notice to affected creditors, the releases were expanded to include the nondebtor tenant's investor owners and lenders, again without any contribution by the releases. At no time during the bankruptcy case did the debtor make any effort to acknowledge or comply with Rule 2002(c)(3). The Rule, amended in 2001, requires explicit disclosures if a plan injunction exceeds the Bankruptcy Code.

Plan Injunctions Trap the Claimant

After the plan was confirmed, the debtor and the nondebtor defendants sought dismissal of Jackson's pending action due to plan confirmation, the discharge and the plan injunction. Jackson then sought clarification or modification of the bankruptcy court's orders to allow his family to proceed directly against two of the defendants nominally, for the purpose of making insurance claims, and against the insider management company, which was uninsured. The bankruptcy court rejected Jackson's due-process arguments, enforced the plan injunctions, and barred the assertion of nominal claims against the defendants. (The defendants, including the debtor, had conceded that nominal action against the debtor was appropriate, but the bankruptcy court disagreed.) The district court affirmed as to all defendants.[2]

Actual Notice Satisfies Due Process

Upon further appeal by Jackson, the Eleventh Circuit also affirmed as to all defendants. The panel easily rejected Jackson's due-process arguments. Jackson's counsel had both actual knowledge of the bankruptcy case and actually received iterations of the plan and injunction/release language. The

1 17 F.4th 1326 (11th Cir. 2021). *See also* "Circuit Expands *Espinosa* to Include Failure to Give Notice of Third-Party Releases," *Rochelle's Daily Wire* (Nov. 17, 2021), *available at* abi.org/newsroom/daily-wire.

2 2020 WL 12604348 (S.D. Fla. 2020); *aff'd*, 17 F.4th 1326 (11th Cir. 2021).

disclosure statement referenced the injunction and release. Notice of the confirmation hearing and deadlines had been provided. Procedural due process requires reasonable notice,[3] but not strict compliance with procedural rules. The circuit analogized to the U.S. Supreme Court's *Espinosa* opinion, which rejected a student lender's post-confirmation challenge to a chapter 13 plan that illegally discharged the debtor's student loans.[4] The fact that the scope of the plan injunctions was expanded on the day of the confirmation hearing without notice to Jackson was immaterial.

No Discussion of Discharging the Debtor's Insurers

The claimants before the Eleventh Circuit had obtained stay relief during the bankruptcy case to permit continuation of their litigation against the debtor to reach insurance, while waiving the right to recourse from the debtor's assets. Most courts understand that the discharge does not bar nominal action against the debtor for the purpose of reaching insurance,[5] because discharged debts "can be collected from any other entity that may be liable."[6] One might think that the drafters of plan injunctions would except nominal claims against the debtor (or third party) for the purpose of obtaining insurance recovery.[7] There is no explicit justification in the opinion, or generally in the law, for a plan provision that expands the debtor's discharge to benefit the debtor's insurers. To the contrary, the Eleventh Circuit's opinion in *Jet Florida* reversed denial of a claimant's motion to modify a chapter 11 confirmation order to permit suit against the reorganized/discharged debtor for the purpose of reaching the debtor's insurance.[8]

In fairness, the architects of the plan would argue that by virtue of interlocking indemnity agreements among the debtor as owner and landlord, the investor-owned tenant, the debtor as manager and the insider sub-manager or operator, suit against the debtor for its insurance claim could allow the insurer to seek third-party relief from the others, who in turn could seek indemnity, thus burdening the reorganization. Yet this conclusion turns § 524(e) on its head. Although the Code provides that the discharge may not extend to third parties, such as insurers and co-defendants, this argument means that a debtor's legal obligations *vis-à-vis* such third parties are sufficient to support a plan injunction that ignores § 524(e).

The Claimant Must Disprove the Need for Third-Party Releases

Although courts comfortable with broad third-party releases perhaps no longer care, § 524(e) provides that the discharge may not "affect the liability of any [nondebtor] entity on, or the property of any [nondebtor] entity for," discharged debt. Courts have expanded the scope of permissible third-party protection beyond narrowly crafted orders in unique circumstances[9] or rare cases.[10] Courts have noted with approval third-party releases in the context of full payment[11] or enjoined claims with substantial evidence of affected creditor consent.[12] Perhaps in partial response, Bankruptcy Rule 2002(c)(3) was amended to require a specific format of disclosures where a plan provides for an injunction protecting "conduct not otherwise enjoined under the Code." This would require notice to creditors sufficient to advise of the need to object to the plan. The Eleventh Circuit's opinion suggests that even a timely objection would not dissuade the plan architects, as the objector has the burden.

> **Waiting until after plan confirmation to seek modification of a plan injunction leaves the claimant at substantial risk of largely unfettered bankruptcy court discretion.**

The Eleventh Circuit historically allows third-party releases in unusual circumstances where the release is necessary for the reorganization and is fair and equitable under all the circumstances.[13] The court also directs bankruptcy courts to consider the seven-factor test from *Dow Corning Corp.*[14] The *Le Centre on Fourth* opinion neither acknowledges nor addresses any of those factors and instead cites with approval an opinion dismissing fraudulent-transfer claims against a discharged debtor and transferees.[15] That opinion flipped *Jet Florida* on its head, as the panel read *Jet Florida* to suggest that the discharge could bar a third party, including insurer claims, unless the claimant demonstrated that the debtor would not experience a material burden if the action were to proceed against the discharged debtor as a nominal defendant.[16]

In fact, *Jet Florida* reversed an order barring claims against the debtor as a nominal defendant in order to reach insurance, noting that there was no burden on the debtor, which could simply default in the action, leaving the insurer to its own devices.[17] Instead, the *SuVicMon Development Inc.* panel's position is that the third-party release is reviewed for abuse of discretion, with the premise that the discharge should be broad and easily expanded by injunction.[18]

The Eleventh Circuit's *Le Centre on Fourth* opinion thus authorizes the bankruptcy court to enter plan injunctions and

3 *Mullane v. Cent. Hanover Bank & Tr. Co.*, 338 U.S. 306, 314 (1950).
4 *United Student Aid Funds Inc. v. Espinosa*, 559 U.S. 260 (2010).
5 *HDR Architecture PC v. Maguire Grp. Holdings*, 523 B.R. 879, 888 (S.D. Fla. 2014) (citing *In re Jet Fla. Sys. Inc.*, 883 F.2d 970 (11th Cir. 1989)).
6 *Blixseth v. Credit Suisse*, 961 F.3d 1074, 1082 (9th Cir. 2020); *cert. denied*, 141 S. Ct. 1394, 209 L. Ed. 2d 132 (2021) (quoting *Landsing Diversified Props.-II v. First Nat'l Bank & Tr. Co. of Tulsa (In re W. Real Estate Fund)*, 922 F.2d 592, 600 (10th Cir. 1990)).
7 *See, e.g., In re City Homes III LLC*, 564 B.R. 827, 863 (Bankr. D. Md. 2017) ("Notwithstanding the foregoing or any other provision of this Plan, Lead-Paint Claimants shall be permitted to bring Lead-Paint Claims against the Debtors and Reorganized Debtors, including their present and former employees and officers, for the purpose of establishing the amount of their liability for such Lead-Paint Claims."). The court rejected nonconsensual third-party releases.
8 *In re Jet Florida Sys. Inc.*, 883 F.2d 970 (11th Cir. 1989).
9 *See, e.g., In re Metromedia Fiber Network Inc.*, 416 F.3d 136, 142 (2d Cir. 2005).
10 *Deutsche Bank AG v. Metromedia Fiber Network Inc. (In re Metromedia Fiber Network Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005).
11 *Id.* at 142.
12 *See In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047 (7th Cir. 1993); *Resorts Int'l v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401-02 (9th Cir. 1995) (allowing consensual release).
13 *In re Seaside Eng'g & Surveying Inc.*, 780 F.3d 1070, 1078 (11th Cir. 2015).
14 *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002).
15 *SuVicMon Dev. Inc. v. Morrison*, 991 F.3d 1213 (11th Cir. 2021).
16 *Id.* at 1223.
17 *In re Seaside Eng'g & Surveying Inc.*, 780 F.3d at 1076-77 n.4.
18 *SuVicMon Dev. Inc. v. Morrison*, 991 F.3d at 1223-24.

continued on page 46