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IN RE MILLENNIUM LAB HOLDINGS II, LLC: THIRD CIRCUIT UPHOLDS NONCONSENSUAL THIRD-PARTY RELEASES OVER *STERN* CONSTITUTIONAL CHALLENGE

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Chapter 11 plans often propose (whether by settlement of claims or otherwise) to release non-debtors from direct claims held by creditors or other third-party stakeholders. Commonly referred to as "third-party" or "non-debtor" releases, these provisions often release and/or enjoin claims (present or future) against the debtor's principals, officers, directors, affiliates, guarantors, insurers, lenders, and other stakeholders when those parties could assert post-confirmation indemnification claims against the debtor, or the non-debtor party is a potential source of funding for the plan of reorganization. While increasingly common in corporate reorganizations, the Bankruptcy Code provides no explicit authority to issue third-party releases, except in the limited context of asbestos liability.[1]

There has been a long-standing federal circuit court split on the issue whether a bankruptcy court may release non-debtors from liability and/or enjoin third parties from asserting their direct claims against non-debtors without the releasing parties' consent. The minority view, held by the Fifth,[2] Ninth[3] and Tenth Circuits,[4] bans

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nonconsensual third-party releases on the basis that § 524(e) of the Bankruptcy Code—which provides generally that "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"—prohibits them. The majority view, in contrast, held by the Second,[5] Third,[6] Fourth,[7] Sixth,[8] Seventh[9] and Eleventh Circuits,[10] allows nonconsensual third-party releases in limited circumstances when supported by necessary factual findings and procedural safeguards, based on the view that § 524(e) merely ensures that discharge of a debtor's debts does not automatically release a co-obligor from liability; that third-party releases are not inconsistent with § 524(e); and that the bankruptcy court has discretion to use its equitable powers under § 105(a) to authorize releases when necessary to carry out a legitimate bankruptcy purpose.

On December 19, 2019, the United States Court of Appeals for the Third Circuit, in *In re Millennium Lab Holdings II, LLC*,[11] addressed a new challenge to nonconsensual third-party releases in Chapter 11 plans of reorganization—whether bankruptcy courts have constitutional authority under *Stern v. Marshall*[12] to approve them. In the first circuit court of appeals opinion to decide the issue, the Third Circuit held that the constitutional authority of bankruptcy courts to approve such releases is well within the confines of *Stern*.

BACKGROUND AND PROCEDURAL HISTORY

Millennium Lab Holdings II, LLC and its wholly owned subsidiaries (the "Company" or "Millennium") provide laboratory-based diagnostic services.[13] The lifeblood of the Company's business was its ability to bill and receive reimbursement from the Centers for Medicare and Medicaid Services ("CMS").[14] In 2012, the United States Department of Justice (the "DOJ") opened an investigation into potential wrongdoings by Millennium in connection with its billing practices.[15] In April 2014, while the investigation was ongoing, Millennium entered into a $1.825 billion credit agreement with a multi-lender syndicate, including various funds and accounts managed by Voya Investment Management Co. LLC and Voya Alternative Asset Management LLC (collectively, "Voya").[16] The government's pending investigation was not disclosed by the Company at the time of the 2014 financing, and approximately $1.3 billion of the loan proceeds was used to pay a special dividend to the Company's shareholders.[17]

Less than a year later, CMS notified Millennium that it intended to revoke the Company's Medicare billing privileges.[18] A month later, in March 2015, the DOJ filed a complaint against Millennium in the United States District Court for the District of Massachusetts, alleging violations of various laws, including the False Claims Act.[19] In May 2015, Millennium reached an agreement in principle with the DOJ, CMS and other government entities to pay $256 million to settle various claims (the "2015 Settlement").[20]

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

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agreement. After informing its lenders of its liquidity issues, Millennium, its principal shareholders, TA Millennium, Inc. ("TA") and Millennium Lab Holdings, Inc. ("MLH"), and an ad hoc group of lenders, including Voya, began negotiating a transaction that would allow the Company to restructure its debt and satisfy the settlement requirements.[21] During these negotiations, the lenders raised potential claims against TA and MLH relating to the 2014 credit agreement, including a lack of disclosure regarding the government's then pending investigation into the Company's business.[22]

While negotiating with the ad hoc group, Millennium informed the government that it could not pay the settlement without restructuring its other financial obligations.[23] The government set a deadline of October 2, 2015, by which the Company was required to finalize a proposal supported by its lenders and equity holders. This deadline was later extended to October 16, 2015.[24]

Millennium, its shareholders, and the ad hoc group engaged in intensive, "highly adversarial," "extremely complicated" and "arm's-length" negotiations that culminated in a restructuring support agreement (the "RSA") entered on October 15, 2015 by the parties to the negotiations—except Voya.[25] Voya refused to approve the settlement, pursuant to which TA and MLH agreed to pay $325 million to fund the Company's obligations to the government and cover certain of Millennium's fees, costs and working capital requirements.[26] The RSA also required the Company's equity holders, including TA and MLH, to transfer 100% of the equity interests in Millennium to the Company's lenders.[27] Voya would receive its share of equity in the deal.[28] In exchange, and as an express condition thereof, Millennium's principal shareholders would be the beneficiaries of releases of all claims, including any third-party lender claims tied to the 2014 financing.[29]

Unable to obtain Voya's consent, Millennium filed Chapter 11 in November 2015, seeking confirmation of a prepacked plan of reorganization ("Plan") that included broad releases (including of third-party claims) in favor of Millennium's shareholders, to be supported and reinforced by a bar order and an injunction prohibiting the pursuit of any released claims (the "Third-Party Releases").[30] A bankruptcy alternative was expressly provided for in the RSA in the event an out-of-court restructuring could not be consummated.

Maintaining that it intended to assert RICO, fraud and related claims against Millennium's shareholders, Voya voted against the Plan and objected to confirmation, arguing that the Third-Party Releases were unlawful, and the bankruptcy court lacked constitutional authority to approve them under *Stern*.[31] The bankruptcy court confirmed the Plan over Voya's objection, and Voya appealed.[32]

In the initial appeal, the district court remanded the case to the bankruptcy court on the issue whether the bankruptcy court had constitutional authority to approve the Third-Party Releases under *Stern*.[33] On remand, the bankruptcy court determined that *Stern* was inapplicable to plan confirmation.[34] Further, that even if *Stern* applied, the Plan complied with its limitations.[35] Voya again appealed to the district court, which affirmed the bankruptcy court. Voya then appealed to the Third Circuit.[36]

HOLDING

In its appeal to the Third Circuit, Voya argued that its alleged RICO/fraud claims against the Company's shareholders did not stem from the bankruptcy itself and would not be resolved in the claims allowance process; therefore, under *Stern*, the bankruptcy court lacked the constitutional authority to confirm a plan releasing its claims.[37] The Third Circuit disagreed. It articulated three takeaways from *Stern* integral to the case at hand: First, even while acting within its "core" statutory authority, a bankruptcy court may violate Article III of the Constitution; second, a bankruptcy court can satisfy Article III concerns when it resolves a matter that is integral to the restructuring of the debtor-creditor relationship; and third, when determining whether a bankruptcy court has acted within its constitutional authority, courts should focus not on the category of the "core" proceeding but rather on the content of the proceeding.[38]

Applying those principles, the Third Circuit

concluded that the bankruptcy court had constitutional authority to confirm the Plan and approve the Third-Party Releases because the releases were integral to the restructuring of the debtor-creditor relationship.[39] Specifically, the releases were critical to the success of the Plan, since, without them, TA and MLH (released non-debtors under the Plan) would not have provided the required funding, which was essential to the Company's ability to continue as a going concern.[40] Without that funding, Millennium would have lost its Medicare billing privileges; would have been forced to liquidate;[41] and would not have been able to make plan distributions, including payment of the 2015 Settlement.[42]

Responding to another argument by Voya, the Third Circuit cautioned that its decision was not intended to open the "floodgates" to the limitless power of the bankruptcy court to approve releases "simply because reorganization financers demand them" and that, in particular, the court was not "broadly sanctioning the permissibility of nonconsensual third-party releases in bankruptcy reorganization plans."[43] Rather, the court reminded that its precedents regarding third-party releases and injunctions, which set forth exacting standards that must be satisfied for their approval, remain in effect.[44]

The court then held that the remaining issues on appeal were equitably moot because striking the releases at issue would "fatally scramble the plan" and "harm a wide range of third parties" that relied on the reorganization (although it stated the test in the disjunctive "and/or"- suggesting that it would have found the appeal to be equitably moot even if only one of those findings had been made).[45]

PRACTICAL POINTERS AND TAKEAWAYS

The holding in *Millennium Lab* reaffirms the ability of plan proponents in the Third Circuit, including Delaware, to obtain third-party releases in Chapter 11 plans over the objection of dissenting creditors with non-blocking positions. Embracing a broader view of constitutional authority of bankruptcy courts than that advocated by Voya, the court determined that it is enough that the issue be "integral to the restructuring" and "critical to the success of the plan." While the court made clear that its decision was limited and based on the specific facts of the case (as are all decisions regarding the propriety of nonconsensual third-party releases by any court in any jurisdiction that allows them), to ensure the constitutional authority of the bankruptcy court to approve nonconsensual third-party releases, plan proponents in the Third Circuit must take care to develop a record evidencing that releases are "integral to the reorganization."[46] As a practical matter, this does not appear to be a significant departure from prior practice—a plan proponent in the Third Circuit must already prove that, in addition to being fair, nonconsensual third-party releases are necessary to the reorganization.[47] From a debtor standpoint, this provides a practical solution to the problem of a holdout creditor refusing to negotiate to the detriment of all creditors. Provided the holdout creditor does not have or obtain a blocking position, approval of nonconsensual third-party releases in appropriate circumstances over objection of the dissenting creditor facilitates one of the key purposes of the Bankruptcy Code—to allow an honest debtor to reorganize over objections of creditors, so long as plan confirmation tests are met.

Whether an issue or proceeding is sufficiently "integral to the restructuring" to confer constitutional authority on the bankruptcy court is sure to be a focus of litigation in future cases in the Third Circuit.[48] Faced with significant costs to litigate plan confirmation issues, dissenting creditors that fear they are unlikely to successfully challenge approval of nonconsensual third-party releases on the merits should consider whether it is more prudent to put their resources toward obtaining a blocking position, if possible, or whether they can align themselves with other creditors to that end.

Finally, the court's interpretation of the "equitable mootness" doctrine is noteworthy in that it raises the question whether appellate challenge to nonconsensual third-party releases approved by a bankruptcy court as "necessary to the reorganization" remains viable in the Third Circuit. This concern aligns with other precedent on the finality of confirmation orders and the circuit's unwillingness to try and "unscramble" large, complicated restructurings.[49]

ENDNOTES:

[1]*See* 11 U.S.C.A. § 524(g).

[2]*Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009); *see Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 760 (5th Cir. 1995) ("we must overturn a § 105 injunction if it effectively discharges a nondebtor").

[3]*Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995).

[4]*Landsing Diversified Props.–II v. First Nat'l Bank & Trust of Tulsa (In re Western Real Estate Fund, Inc.)*, 922 F.2d 592, 601-02 (10th Cir. 1990).

[5]*Deutsche Bank AG v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005).

[6]*Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 214 (3d Cir. 2000); *In re Lower Bucks Hosp.*, 571 F. App'x 139, 144 (3d Cir. 2014); *In re Global Indus. Techs., Inc.*, 645 F.3d 201, 206 (3d Cir. 2011) (en banc).

[7]*Behrmann v. National Heritage Found.*, 663 F.3d 704 (4th Cir. 2011).

[8]*Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648 (6th Cir. 2002).

[9]*Airadigm Commc'ns, Inc. v. FCC (In re Airadigm Commc'ns, Inc.)*, 519 F.3d 640 (7th Cir. 2008).

[10]*SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, 780 F.3d 1070 (11th Cir. 2015).

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

[12]*Stern v. Marshall*, 564 U.S. 462, 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011) ("*Stern*").

[13]*Millennium Lab*, 945 F.3d at 130.

[14]*Millennium Lab*, 945 F.3d at 130.

[15]*Millennium Lab*, 945 F.3d at 130.

[16]*Millennium Lab*, 945 F.3d at 130.

[17]*Millennium Lab*, 945 F.3d at 130.

[18]*Millennium Lab*, 945 F.3d at 130.

[19]*Millennium Lab*, 945 F.3d at 130.

[20]*Millennium Lab*, 945 F.3d at 130-31.

[21]*Millennium Lab*, 945 F.3d at 130.

[22]*Millennium Lab*, 945 F.3d at 130.

[23]*Millennium Lab*, 945 F.3d at 130.

[24]*Millennium Lab*, 945 F.3d at 130.

[25]*Millennium Lab*, 945 F.3d at 131.

[26]*Millennium Lab*, 945 F.3d at 131.

[27]*Millennium Lab*, 945 F.3d at 131.

[28]*Millennium Lab*, 945 F.3d at 131.

[29]*Millennium Lab*, 945 F.3d at 131-32.

[30]*Millennium Lab*, 945 F.3d at 132.

[31]*Millennium Lab*, 945 F.3d at 132. In brief, the Supreme Court held in *Stern* that under Article III of the Constitution, the bankruptcy court lacked the authority to enter a final judgment on a debtor's state law counterclaim, even where the court had statutory authority under the bankruptcy code and the claim was a "core" proceeding. *Stern*, 564 U.S. at 484. In opposition, the debtor argued that because the creditor had filed a proof of claim, the bankruptcy court had the constitutional authority to resolve the counterclaim as part of the claims allowance process. *Stern*, 564 U.S. at 495. In rejecting that argument, the Supreme Court observed that the question is not whether the subject action has "some bearing" on the bankruptcy case but "whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process." *Stern*, 564 U.S. at 499.

[32]*Millennium Lab*, 945 F.3d at 132.

[33]*Millennium Lab*, 945 F.3d at 132.

[34]*Millennium Lab*, 945 F.3d at 133.

[35]*Millennium Lab*, 945 F.3d at 133.

[36]*Millennium Lab*, 945 F.3d at 133.

[37]*Millennium Lab*, 945 F.3d at 137-38.

[38]*Millennium Lab*, 945 F.3d at 135-37.

[39]*Millennium Lab*, 945 F.3d at 137-39.

[40]*Millennium Lab*, 945 F.3d at 137.

[41]Presumably, creditors would have been worse off in a Chapter 7 liquidation or in a liquidating Chapter 11.

[42]*Millennium Lab*, 945 F.3d at 137.

[43]*Millennium Lab*, 945 F.3d at 139.

[44]*Millennium Lab*, 945 F.3d at 139 (citing *In re Global Indus. Techs., Inc.*, 645 F.3d 201, 206 (3d Cir. 2011) (en banc) (explaining that suit injunctions must be "both necessary to the reorganization and fair"); *In re Continental Airlines, Inc.*, 203 F.3d 203, 214 (3d Cir. 2000) ("The hallmarks of permissible non-consensual releases [are] fairness, necessity to the reorganization and specific factual findings to support these conclusions.")).

[45]*Millennium Lab*, 945 F.3d at 144.

[46]*Millennium Lab*, 945 F.3d at 137-39.

[47]*Continental Airlines*, 203 F.3d at 214.

[48]Note that the Third Circuit Court of Appeals is the first circuit court of appeals to address a *Stern* challenge to a bankruptcy court's authority to approve nonconsensual third-party releases. In time, similar arguments are likely to be advanced in, and addressed by, other circuit courts that otherwise allow these types of releases.

[49]*See, e.g.*, *In re Allied Nev. Gold Corp.*, 725 F. App'x 144, 149 (3d Cir. 2018) (Our recent decisions have synthesized the test for equitable mootness as proceeding in two analytical steps: (1) whether a confirmed plan has been substantially consummated; and (2) if so, whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.) (internal citations and quotations omitted).

