Availability of Relief for Non-Debtor Entities and Non-Asbestos-Related Liabilities Under the Bankruptcy Code

Jeffrey N. Rich
Eric T. Moser*
INTRODUCTION

Section 524(g) of the Bankruptcy Code is designed to authorize the granting of the kind of broad-ranging injunctive relief that is necessary to facilitate a comprehensive resolution of a debtor’s asbestos-related liabilities.\(^1\) In order to accomplish this result, section 524(g) of the Bankruptcy Code authorizes the issuance of an injunction, in connection with an order confirming a plan of reorganization, to supplement the injunctive effect of the discharge created by section 1141 of the Bankruptcy Code with respect to the present and future asbestos–related liabilities of a debtor and certain related non-debtor parties by enjoining “entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any claim or demand that, under a plan of reorganization, is to be paid in whole or in part by a trust . . . .”\(^2\)

Fortunately, in enacting section 524(g) of the Bankruptcy Code, which is modeled after the trust and channeling injunction structure used in connection with the Johns-Manville and UNR bankruptcies,\(^3\) Congress had sufficient foresight to recognize that not all asbestos-related liabilities would necessarily fit within the relational categories specified by 11 U.S.C. § 524(g)(4)(A)(ii), and that asbestos was not the only substance that could precipitate a mass-tort litigation crisis requiring extraordinary relief. In fact, in order to avoid any inferential limitation on the power of a bankruptcy court to craft the extraordinary equitable relief that might be required by the exigencies of a

\(^2\) 11 U.S.C. § 524(g)(1).
\(^3\) Id.
particular case, the Bankruptcy Reform Act of 1994, which added section 524(g) to the Bankruptcy Code,\(^4\) expressly provides that the enactment of section 524(g) should not be “construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with the confirmation of a plan of reorganization.”\(^5\)

Accordingly, while Congress has expressly sanctioned the issuance of a permanent channeling injunction in the limited circumstances specified by section 524(g) of the Bankruptcy Code, it has also preserved the possibility that similar relief might be available in other appropriate cases, whether or not involving asbestos, in an exercise of the equitable and statutory powers of the bankruptcy court. Section 524(g) is thus a legislative safe-harbor, and does not serve as an affirmative limitation on the authority otherwise vested in the bankruptcy courts. Consistent with this safe-harbor status, numerous courts, both before and after the enactment of section 524(g), have confirmed the bankruptcy courts’ power to enter permanent releases and supplemental channeling injunctions in order to facilitate the comprehensive resolution of a wide variety of asbestos and non-asbestos-related claims.\(^6\) These courts have also confirmed that bankruptcy courts have the power to extend the benefit of such relief to non-debtors, at

\(^4\) Pub. L. No. 103-394, § 111(a).
\(^5\) Pub. L. No. 103-394, § 111(b).
least where unusual circumstances are present that warrant the grant of such extraordinary relief.7

Notwithstanding the fact that channeling injunctions have been entered with respect to non-debtor liabilities for decades, and have become a normal part of modern bankruptcy practice, their availability and use remains controversial and continues to be the subject of hotly contested litigation. Indeed, there is even a circuit split regarding whether such relief is ever consistent with the applicable provisions of the Bankruptcy Code, including specifically section 524(e). Furthermore, as discussed more fully below, even among courts that recognize the permissibility of non-debtor injunctive relief, there is little consensus regarding the applicable legal standards for granting permanent injunctive relief to non-debtors.

Rather than attempting to resolve these disputes, however, this paper is simply intended to provide an overview of the current state of the law regarding the availability of non-debtor injunctive relief and the various standards that have been articulated for the purpose of governing its use.

I. Is Permanent Injunctive Relief Available to Non-Debtor Parties Under the Bankruptcy Code?

Apart from section 524(g) itself, the Bankruptcy Code does not expressly address the question of whether or under what circumstances a bankruptcy court has the

7 See, e.g., Matter of Munford, Inc., 97 F.3d 449, 456 (11th Cir. 1996) (affirming the entry of an injunction precluding the assertion of claims for contribution and indemnity against non-debtor defendants that had agreed to settle the debtor’s claims against them); In re Drexel Burnham, 960 F.2d at 293 (“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.”) (citing A.H. Robins); MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 94 (2d Cir. 1988) (affirming permanent injunction against suits by non-debtor coinsured against insurers with whom the debtors had reached settlements).
power to release non-debtors from their liabilities to third-parties by means of a supplemental channeling injunction entered in connection with the confirmation of a plan of reorganization or otherwise. Yet, the express statutory authority provided by section 524(g) of the Bankruptcy Code is not necessarily broad enough to provide for a comprehensive resolution of all of the different kinds of liabilities faced by debtors and their non-debtor affiliates in the course of modern mass-tort litigation. As a result, bankruptcy courts have had to look to their inherent equitable and statutory authority under sections 105 and 1123(b)(6) of the Bankruptcy Code to fill in the interstices and permit the granting of the kind of truly comprehensive injunctive relief that may be necessary to facilitate a debtor’s successful reorganization, while at the same time ensuring the fair and equitable compensation of present and future victims of mass torts.

Unfortunately, due to the general legislative silence on the question of the release of non-debtor liabilities, and in the absence of any meaningful guidance from the Supreme Court, it is somewhat unsurprising that courts have come to drastically different conclusions regarding the availability and scope of non-debtor injunctive relief under the Bankruptcy Code.

A. **Scope of Non-Debtor Protection Available Under Section 524(g)**

There is no doubt that section 524(g) of the Bankruptcy Code represents an extremely important source of relief for debtors and their non-debtor affiliates facing asbestos-related liabilities. However, the statutory language of section 524(g) was designed to deal with a particular mass-tort crisis, and is not necessarily sufficiently flexible or expansive to serve as a panacea for all mass-tort liabilities, or even for all asbestos-related liabilities.
While the language of section 524(g) has been interpreted to be sufficiently broad to authorize the issuance of a supplemental channeling injunction with respect to both asbestos-related liabilities and non-asbestos-related liabilities, it expressly authorizes the extension of that injunctive relief to non-debtor entities only to the extent the liabilities asserted against them fall within the specific relational categories enumerated in section 524(g)(4)(A)(ii). Specifically, section 524(g) authorizes the extension of injunctive relief to non-debtors only to the extent that the non-debtor party:

is alleged to be directly or indirectly liable for the conduct of, claims against, or demands on the debtor to the extent such alleged liability of such third party arises by reason of:

(I) the third party’s ownership of a financial interest in the debtor, a past or present affiliate of the debtor, or a predecessor in interest of the debtor;

(II) the third party’s involvement in the management of the debtor or a predecessor in interest of the debtor, or service as an officer, director or employee of the debtor or a related party;

(III) the third party’s provision of insurance to the debtor or a related party; or

(IV) the third party’s involvement in a transaction changing the corporate structure, or in a loan or other financial transaction affecting the financial condition, of the debtor or a related party, including but not limited to --

(a) involvement in providing financing (debtor or equity), or advice to an

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8 See In re Eagle-Picher Industries, Inc., 203 B.R. 256, 267 (S.D. Ohio 1996) (issuing channeling injunction with respect to both asbestos and lead-related liabilities, noting that while section 524(g) was enacted principally to respond to asbestos-related liabilities, “the language of the statute itself contains no requirement that claims of another sort must be excluded from the trust.”).
entity involved in such a transaction;

or

(bb) acquiring or selling a financial interest in an entity as part of such a transaction.9

While these categories are broad, they are not without limits, and section 524(g) of the Bankruptcy Code has been interpreted not to authorize supplemental injunctive relief with respect to the genuinely independent asbestos-related liabilities of non-debtor parties (i.e. liabilities that are not also liabilities of the debtor).10

Nevertheless, because the channeling of such independent non-debtor liabilities is sometimes necessary to facilitate a debtor’s reorganization, and to achieve the fair and equitable treatment of mass-tort claimants, some courts have found that the channeling of liabilities falling outside of the scope of section 524(g) is permissible in an exercise of their inherent equitable power and statutory authority under sections 105 and 1123(b)(6) of the Bankruptcy Code.11 The availability of such relief remains controversial as discussed in greater detail in the following section, and is in fact a principal subject of the appeal before the Third Circuit arising out of the Combustion Engineering bankruptcy.12

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10 See In re Combustion Eng’g, Inc. 295 B.R. 459, 482 (Bankr. D. Del. 2003) (“The § 524(g) channeling injunction cannot apply to Basic’s and Lummus’s independent liabilities, however, as that type of protection for a nondebtor is simply not available under § 524(g).”).
11 See id. at 483.
B. Protection of Non-Debtors and Liabilities Outside of Section 524(g)

1. Majority View: Permanent Injunctive Relief Is Available to Non-Debtors Under Special Circumstances

A majority of the circuit courts of appeal (and numerous other courts) have recognized that extraordinary circumstances can, at least in principle, justify the non-consensual release and channeling of claims against non-debtors under the Bankruptcy Code, regardless of whether such relief is independently available under section 524(g) of the Bankruptcy Code. To date, the Second, Fourth, Sixth and Eleventh Circuits have all approved permanent injunctions prohibiting the assertion of specified liabilities against non-debtor third parties, principally on the basis of section 105(a) of the Bankruptcy Code, which authorizes the issuance of “any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title,” 11 U.S.C. § 105(a), as well as the bankruptcy court’s inherent power as a court of equity with

13 See Matter of Munford, Inc., 97 F.3d 449, 456 (11th Cir. 1996); In re Dow Corning Corp., 280 F.3d 648 (6th Cir. 2002); SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 293 (2d Cir. 1992); Menard-Sanford v. Mabey (In re A.H. Robins Co.), 880 F.2d 694, 702 (4th Cir. 1989) (Dalkon Shield claims).

14 The Dow Corning court also relied on section 1123(b)(6) of the Bankruptcy Code, which authorizes the inclusion in a plan of reorganization of “other appropriate provisions not inconsistent with the applicable provisions of this title.” See Dow Corning, 280 F.3d at 656-57 (“[S]uch an injunction is ‘not inconsistent’ with the Code, and is authorized by section 1123(b)(6).”).

The Munford court drew additional support for non-debtor injunctive relief in the context of a settlement from Rule 7016 of the Federal Rules of Bankruptcy Procedure, which provides that “the court may take appropriate action with respect to settlement and the issue of special procedures to assist in resolving the dispute when authorized by statute or local rule.” Munford, 97 F.3d at 454-55 (“Section 105(a) clearly provides that the bankruptcy court can enter ‘any order’ necessary or appropriate to carry out the provisions of the Bankruptcy Code, while rule 16 authorizes the use of special procedures to assist the parties in reaching a settlement.”).
“broad authority to modify creditor-debtor relationships.”

Additionally, while not expressly sanctioning non-debtor injunctive relief, the Third, Fifth, Seventh and District of Columbia Circuits have intimated their conceptual approval for non-debtor releases and permanent channeling injunctions, at least under certain extraordinary circumstances and/or with the consent of the affected parties.

Finally, while the First Circuit has expressly declined to address the validity of precedents authorizing non-debtor releases, it refused to disturb an unappealed bankruptcy court order granting such releases finding that the order “cited precedent” and was not so “patently incorrect” as to justify an exception to the normal rule preventing collateral attack of final judgments.

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15 In re Dow Corning, 280 F.3d at 656 (quoting United States v. Energy Resources Co., 495 U.S. 545, 549 (1990)).

16 As noted above, the issue of the propriety of granting non-debtor injunctive relief outside of the scope of section 524(g) is presently pending before the Third Circuit in the context of the In re Combustion Eng’g, Inc. appeal, the outcome of which may shed further light on the law of the Third Circuit on this subject.

17 See In re Continental Airlines, 203 F.3d 203, 214 (3d Cir. 2000) (refusing to establish a definitive rule regarding non-debtor releases because, on the facts of the case before it, the “hallmarks of permissible non-consensual releases – fairness, necessity to the reorganization, and specific factual findings to support these conclusions – [were] all absent.”); Feld v. Zale Corp. (Matter of Zale Corp.), 62 F.3d 746, 760 (5th Cir. 1995) (refusing to approve permanent injunction that effectively discharged claims against non-debtors, but distinguishing cases in which claims were channeled to an alternate source of recovery); In re Specialty Equip. Cos., 3 F.3d 1043, 1047 (7th Cir. 1993) (“[A] per se rule disfavoring all releases in a reorganization plan would be . . . unwarranted. Accordingly, courts have found releases that are consensual and non-coercive to be in accord with the strictures of the Bankruptcy Code.”); In re AOV Indus., 792 F.2d 1140, 1153 (D.C. Cir. 1986) (approving a plan provision that required that creditors release certain claims against non-debtors in order to receive a distribution).

18 Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 983 (1st Cir. 1995) (“We express no view on the soundness of the precedents cited in the confirmation order, nor on their applicability to the particular plan proposed by Monarch Life. The proper

In contrast to the majority view that recognizes that non-debtor releases and injunctive relief can be appropriate in extraordinary cases, the Ninth and Tenth Circuits have held that the Bankruptcy Code categorically prohibits a bankruptcy court from releasing and/or permanently enjoining the enforcement of liabilities against non-debtor parties.¹⁹

In the view of these courts, while bankruptcy courts have broad equitable discretion under section 105 of the Bankruptcy Code to enter a variety of temporary and permanent injunctions, they may not use that discretion to “authorize relief inconsistent with more specific law.”²⁰ Accordingly, because, in the view of the Ninth and Tenth Circuits, a permanent release of non-debtor liabilities constitutes a discharge of those liabilities within the meaning of section 524(a) of the Bankruptcy Code,²¹ such non-recourse for addressing those questions was by direct appeal from the order of confirmation.”.

¹⁹ See American Hardwoods, Inc. v. Deutsche Credit Corp. (In re American Hardwoods, Inc.), 885 F.2d 621, 627 (9th Cir. 1989) (“We hold that the district court did not err in concluding that it lacked power to enjoin Deutsche permanently from enforcing its state court judgment against the Keelers.”); Landsing Diversified Properties-II v. First Nat’l Bank & Trust Co. of Tulsa (In re Western Real Estate Fund, Inc.), 922 F.2d 59, 601 (10th Cir. 1990) (following American Hardwoods and vacating permanent injunction of claims against non-debtors).

²⁰ American Hardwoods, 885 F.2d at 625.

²¹ See American Hardwoods, 885 F.2d at 626 (“We find American’s semantic distinction between a permanent injunction and a discharge unpersuasive. . . . The
debtor relief, whether styled as a release, injunction, or otherwise, falls within the scope of the prohibition of section 524(e) of the Bankruptcy Code, which provides, in pertinent part, that “discharge of a debt of the debtor does not affect the liability of any other entity.”

II. What Standards Govern the Grant of Permanent Injunctive Relief to Non-Debtors?

Courts generally agree that non-debtor injunctions and releases are not appropriate in every Chapter 11 case, and should be used only where unusual circumstances warrant extraordinary relief. Even among courts that recognize the permissibility of granting permanent non-debtor releases and injunctive relief, however, there is a substantial variation in the verbal formulations of the legal standards applicable to granting that relief.

In the Second Circuit, releases and injunctive relief are available to non-debtors to the extent “a material benefit results to the Debtors’ estates and advances consummation of a Plan.” SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.), 960 F.2d 285, 292 (2d Cir. 1992). The Third Circuit has suggested that such relief should be available only where the “hallmarks of permissible non-consensual relief – fairness, necessity to the reorganization, and specific factual findings to support these conclusions” are present. In re Continental Airlines, 203 F.3d 203, 214 (3d Cir. 2000). The Fourth Circuit has likewise held that non-debtor injunctive relief requested by American falls squarely within the definition of a discharge under section 524(a)(2).”}


23 Whether these differing formulations of the standard for non-debtor injunctive relief represent different substantive legal standards or are merely differing articulations of a common standard remains to be determined by subsequent case law.
relief is appropriate in cases where “the entire reorganization hinges on the” injunction. Menard-Sanford v. Mabey (In re A.H. Robins Co. Inc.), 880 F.2d 694, 702 (4th Cir. 1989). The Eleventh Circuit has held that non-debtor injunctive relief is available where “integral to settlement in an adversary proceeding.” In re Munford, Inc., 97 F.3d 449, 455 (11th Cir. 1996).

In an effort to synthesize the various elements that courts have considered in determining whether to grant non-debtor releases or inunctive relief, the Sixth Circuit has established a seven-factor test governing the availability of non-debtor injunctive relief. Under the Dow Corning test:

[W]hen the following seven factors are present, the bankruptcy court may enjoin a non-consenting creditor’s claims against a non-debtor

(1) there is an identity of interests between the debtor and a third party . . . such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete the assets of the estate;

(2) the nondebtor has contributed substantial assets to the reorganization;

(3) the injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor;

(4) the impacted class, or classes, has overwhelmingly voted to accept the plan;

(5) the plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;

(6) the plan provides an opportunity for those claimants who choose not to settle to recover in full and;

24 In re Dow Corning Corp., 280 F.3d at 658.
In stark contrast with the substantial amount of judicial and scholarly attention that has been devoted to the propriety of extending permanent injunctive relief to non-debtors under the Bankruptcy Code, there is virtually no case law or academic commentary challenging the bankruptcy court’s ability to supplement the effect of the discharge with respect to a debtor’s own present and future non-asbestos-related liabilities.

Of course, any effort to deal with unknown future claimants, whether or not against the debtor, must necessarily comport with the fundamental requirements of due process. However, the fact that the liabilities in question do not relate to asbestos does not appear to present an independent obstacle to the entry of a channeling injunction. As the United States District Court for the Southern District of Ohio noted in confirming a plan of reorganization for Eagle-Picher Industries, Inc.:

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27 See Waterman Steamship Corp. v. Aguiar (In re Waterman Steamship Corp.), 157 B.R. 220, 221 (S.D.N.Y. 1993) (“Due process requires the provision of reasonable notice to those parties whose claims are to be discharged.”).
While it is true that the provisions of § 524(g) were enacted to deal with the overwhelming problems facing industry and society because of asbestos claims, the language of the statute itself contains no requirement that claims of another sort must be excluded from the trust.

In re Eagle-Picher Industries, Inc., 203 B.R. 256, 267 (S.D. Ohio 1996). Thus, as long as asbestos liabilities are dealt with under a plan, the statutory mechanisms created by section 524(g) may also be used to address other kinds of liabilities. Even in cases where asbestos liability is not at issue, under the law of most circuits, it would appear that the bankruptcy court’s equitable authority under sections 105 and 1123(b)(6) is itself sufficient to permit the grant of injunctive relief with respect to non-asbestos-related liabilities that is substantially similar to that contemplated by section 524(g) of the Bankruptcy Code.

IV. Prospects for a Legislative Solution to Asbestos-Related Liabilities

On April 7, 2004, the Fairness in Asbestos Injury Resolution Act of 2004 (S. 2290) was introduced on the floor of United States Senate as part of an ongoing effort to enact comprehensive asbestos reform legislation. S. 2290, if enacted, would have created an approximately $114 billion Asbestos Injury Claims Resolution Fund, funded by contributions from the defendants of asbestos-related litigation and their insurers, and designed to create a consistent national system of compensation for victims of asbestos-related disease outside of the traditional tort system.

On April 22, 2004, the proponents of S. 2290 failed to garner sufficient votes to invoke cloture and force a vote on the bill, and have not announced any intention to seek reconsideration of the proposed legislation at any time in the near future. Consequently, the prospects for a comprehensive legislative solution to the problem of
the asbestos litigation crisis are decidedly uncertain at this time. Even if such legislation were to be enacted, however, it would, at least in its present form, address only asbestos-related liabilities, and would not even purport to resolve other sources of mass-tort liabilities. Accordingly, the issue of whether and to what extent the Bankruptcy Code authorizes the non-consensual release and injunction of non-debtor liabilities seems certain to endure for years to come.