

THE CONSTITUTIONAL PROBLEM OF NONDEBTOR RELEASES IN BANKRUPTCY

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In recent years, nondebtor releases have become a common feature of big-case Chapter 11 bankruptcy practice. Nondebtor releases involve the release of creditor claims against third-party nondebtors pursuant to a bankruptcy plan confirmation order. Some nondebtor releases are consensual, meaning that they are done with the assent of the releasing creditor, but some are not.

This Essay argues that all nonconsensual nondebtor releases in bankruptcy are unconstitutional. The constitutional infirmities of nondebtor releases are layered:

- *all nondebtor releases—consensual and nonconsensual—are outside the scope of Congress’s authority under an original understanding of the Bankruptcy Clause;*
- *all nonconsensual nondebtor releases are inconsistent with due process’s requirement of an adjudication; and*
- *all releases of claims that have not yet ripened into actual litigation or that do not involve sufficiently immediate and real disputes are outside the scope of Article III jurisdiction.*

These layered constitutional restrictions do not preclude all nondebtor releases. Consensual releases of ripened claims are still possible pursuant to the organic powers of federal courts. In light of the concern about constitutional abuses, however, courts should apply strict scrutiny when reviewing the adequacy of consent and when determining whether there is federal subject-matter jurisdiction.

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INTRODUCTION

Over the past two decades, nondebtor releases have become a routine feature of big-case Chapter 11 practice.¹ They are often viewed as an essential tool in addressing mass torts in bankruptcy and are viewed by many Chapter 11 practitioners as a useful deal lubricant. And they are unconstitutional.

Nondebtor releases come in two varieties: consensual and nonconsensual. A consensual release is simply another name for a settlement of a creditor's claim against a nondebtor. Such a release need occur in bankruptcy only when it involves not just a creditor's claim against a nondebtor, but also property of the bankruptcy estate—effectively functioning as a three-party settlement.² Otherwise, the creditor and the nondebtor are free to enter into their own private, bilateral settlement outside of court.

Nonconsensual nondebtor releases are a different story. Because such releases are nonconsensual—i.e., they are imposed on the creditor—they cannot, by definition, occur in private, bilateral settlements that require mutual assent. Instead, they can come into existence solely by force of court order, specifically a bankruptcy plan confirmation order. This Essay argues that all nonconsensual nondebtor releases—including those entered in

1. *See, e.g.*, *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 636 B.R. 641, 654–55 (Bankr. E.D. Va. 2022) (noting the “ubiquity of third-party releases”); *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019) (“Almost every proposed Chapter 11 Plan that I receive includes proposed releases.”); *In re FirstEnergy Sols. Corp.*, 606 B.R. 720, 737 (Bankr. N.D. Ohio 2019) (“The Court takes notice that this is far from the only pending bankruptcy case in which broad nonconsensual third-party releases of nondebtors are being sought.”).

2. Bankruptcy law requires court approval of the use, sale, or lease of property of the estate outside of the ordinary course of business. 11 U.S.C. § 363(b). Almost all settlements will be outside of the ordinary course of business. Moreover, Federal Rule of Bankruptcy Procedure 9019 requires court approval of settlements with the bankruptcy estate. FED. R. BANKR. P. 9019.

asbestos bankruptcy cases under § 524(g) of the U.S. Bankruptcy Code³—are illegal.

There are three possible fonts of authority for nondebtor releases of any sort in bankruptcy: statutory authorization by Congress, the common law-making powers of federal courts, or some general penumbra of equity powers of the bankruptcy courts. The U.S. Constitution precludes each one of these possible bases of authority for nonconsensual releases. Congress lacks authority under the Bankruptcy Clause to authorize all manner of nondebtor releases, and the Fifth Amendment’s Due Process Clause prohibits Congress from enacting—and the courts from entering—nonconsensual nondebtor releases. What’s more, federal courts lack Article III jurisdiction to enter most nondebtor releases.⁴ These limitations preclude most, but not all, nondebtor releases. Consensual releases of creditors’ ripened claims against a nondebtor may still lie within the organic powers of federal courts when the property of the bankruptcy estate is involved. Table 1 summarizes these layered constitutional arguments.

Table 1: Constitutional Limitations on Nondebtor Releases

	Release Pursuant to Congressional Authorization	Release Under Federal Courts’ Organic Powers
<i>Nonconsensual Releases</i>	<ul style="list-style-type: none"> • Outside scope of Bankruptcy Clause • Inconsistent with Due Process Clause 	<ul style="list-style-type: none"> • Inconsistent with due process
<i>Consensual Releases</i>	<ul style="list-style-type: none"> • Outside scope of Bankruptcy Clause 	<ul style="list-style-type: none"> • Allowed, but limited by Article III to releases of ripened claims

No court has squarely addressed these issues yet.⁵ Instead, existing jurisprudence addresses peripheral issues premised on the assumption that nondebtor releases are allowed in some circumstances, such as whether a non-Article III court can enter a nonconsensual nondebtor release⁶ or what

3. 11 U.S.C. § 524(g).

4. Federal courts also lack statutory subject-matter jurisdiction for releases of unripened claims. *See infra* note 56.

5. *But see In re Aegean Marine*, 599 B.R. at 723–25 (noting incompatibility of nonconsensual nondebtor releases with due process while noting that precedent in some circuits contemplates releases in certain circumstances).

6. *See, e.g., Lynch v. Lapidem Ltd. (In re Kirwan Offs. S.À.R.L.)*, 592 B.R. 489, 503 (Bankr. S.D.N.Y. 2018); *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 140–44 (3d Cir. 2019).

sort of notice is required.⁷ While some courts have found statutory authority for nondebtor releases to be lacking (other than in the asbestos context, pursuant to a specific provision of the Bankruptcy Code),⁸ no court has addressed the constitutional authority for nondebtor releases. Instead, virtually all of the court rulings that have authorized nonconsensual nondebtor releases have done so without any consideration of their constitutionality.⁹ Accordingly, the argument here is derived from my own

7. See, e.g., *MacArthur Co. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 837 F.2d 89, 94 (2d Cir. 1988); *In re Le Centre on Fourth, LLC*, 17 F.4th 1326, 1334 (11th Cir. 2021); *Patterson v. Mahwah Bergen Retail Grp., Inc.*, 636 B.R. 641, 687–88 (Bankr. E.D. Va. 2022) (noting that the insufficiency of notice of releases violated due process).

8. See *In re Landsing Diversified Props.-II v. First Nat'l Bank & Tr. Co.* (*In re W. Real Est. Fund, Inc.*), 922 F.2d 592, 600 (10th Cir. 1991) (holding discharging liability of a third party to a bankruptcy proceeding to be improper); *Feld v. Zale Corp.* (*In re Zale Corp.*), 62 F.3d 746, 760 (5th Cir. 1995) (“[W]e must overturn a § 105 injunction if it effectively discharges a nondebtor.”); *Bank of N.Y. Tr. Co. v. Off. Unsecured Creditors’ Comm.* (*In re Pac. Lumber Co.*), 584 F.3d 229, 252 (5th Cir. 2009) (“In a variety of contexts, this court has held that Section 524(e) only releases the debtor, not co-liable third parties.”). Matters are more complex in the U.S. Court of Appeals for the Ninth Circuit. The court has three times refused to approve nondebtor releases. *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985); *Am. Hardwoods, Inc. v. Deutsche Credit Corp.* (*In re Am. Hardwoods, Inc.*), 885 F.2d 621, 626 (9th Cir. 1989); *Resorts Int’l, Inc. v. Lowenschuss* (*In re Lowenschuss*), 67 F.3d 1394, 1401 (9th Cir. 1995). Yet it has more recently permitted narrow exculpation of post-petition acts by parties related to the plan approval process without repudiating those earlier precedents. *Blixseth v. Credit Suisse*, 961 F.3d 1074, 1081–82 (9th Cir. 2020).

9. See, e.g., *In re Johns-Manville Corp.*, 837 F.2d at 93–94 (affirming the district court’s decision to affirm the bankruptcy court’s order enjoining claims against the debtor’s insurers because “the insurance settlement/injunction arrangement was essential . . . to a workable reorganization”); *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 694, 701–02 (4th Cir. 1989) (affirming the district court’s decision to enjoin claims against third-party nondebtors because allowing these suits would “defeat” the reorganization plan); *Gillman v. Cont’l Airlines* (*In re Cont’l Airlines*), 203 F.3d 203, 212–13, 217 (3d Cir. 2000) (recognizing that the U.S. Courts of Appeals for the Second and Fourth Circuits have upheld nondebtor releases in “extraordinary cases” and holding that “the Bankruptcy Court and District Court [in this case] lacked a sufficient evidentiary and legal basis to authorize the release and permanent injunction of Plaintiffs’ claims under any of the standards adopted by courts that have evaluated non-debtor releases and permanent injunctions”); *Class Five Nev. Claimants v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 658 (6th Cir. 2002) (following “those circuits that have held that enjoining a non-consenting creditor’s claim is only appropriate in ‘unusual circumstances’”); *In re Combustion Eng’g, Inc.*, 391 F.3d 190, 236–38, 237 n.50 (3d Cir. 2004) (distinguishing cases involving asbestos-related claims and claims under 11 U.S.C. § 524(g) from the claims in *In re A.H. Robins Co.*, *In re Dow Corning Corp.*, and *SEC v. Drexel Burnham Lambert Grp., Inc.* (*In re Drexel Burnham Lambert Grp., Inc.*), 960 F.2d 285 (2d Cir. 1992), and vacating the order enjoining claimants of the nondebtors); *Deutsche Bank AG v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 141 (2d Cir. 2005) (holding an appeal to be equitably moot but noting in dicta that “[w]hile none of our cases explains when a nondebtor release is ‘important’ to a debtor’s plan, it is clear that such a release is proper only in rare cases”); *Airadigm Commc’ns, Inc. v. FCC* (*In re Airadigm Commc’ns, Inc.*), 519 F.3d 640, 657 (7th Cir. 2008) (holding that bankruptcy courts are permitted “to release third parties from liability to participating creditors if the release is ‘appropriate’ and not inconsistent with any provision of the bankruptcy code”); *In re Ingersoll, Inc.*, 562 F.3d 856, 865 (7th Cir. 2009) (upholding a nondebtor release because the release was an “essential component” of the bankruptcy plan under the “unique circumstances of this case”); *Behrmann v. Nat’l Heritage Found., Inc.*, 663 F.3d 704, 711 (4th Cir. 2011) (concluding that bankruptcy courts can authorize nondebtor releases “where circumstances warrant”); *Nat’l Heritage Found., Inc. v. Highbourne Found.*,

application of various constitutional provisions, as well as of bankruptcy court and U.S. Supreme Court precedents in other contexts, to the question of nondebtor releases.¹⁰

I am hardly the first to suggest that nonconsensual nondebtor releases are unconstitutional, although commentators have pointed to a range of constitutional infirmities. Two decades ago, Professor Thomas E. Plank raised both Bankruptcy Clause and Due Process Clause concerns in the context of an article focused on the extra-statutory lawmaking authority of federal courts in bankruptcy.¹¹ More recently, the U.S. Department of Justice raised the Due Process Clause as a basis for challenging the confirmation of Purdue Pharma's bankruptcy plan.¹² Professor Ralph Brubaker has argued that nondebtor releases violate the separation of powers principle embodied in the prohibition on general, federal common law-making in *Erie Railroad Co. v. Tompkins*,¹³ and Professor Brubaker, joined by other scholars as amici curiae in the Purdue Pharma bankruptcy, has also argued that the nonconsensual releases of certain claims (namely legal, as opposed to equitable claims) violate the Seventh Amendment's right to a jury trial.¹⁴ More recently, Judge Michael E. Wiles of the U.S. Bankruptcy Court for the

760 F.3d 344, 351–52 (4th Cir. 2014) (holding that a debtor must “demonstrate that it faces exceptional circumstances justifying the enforcement of” a nondebtor release and that to “obtain approval of a non-debtor release . . . a debtor must provide adequate factual support to show that the circumstances warrant such exceptional relief”); (SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (*In re Seaside Eng'g & Surveying, Inc.*), 780 F.3d 1070, 1078–79 (11th Cir. 2015) (holding that a nondebtor release or bar order “should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts and circumstances”); *In re Millennium Lab Holdings II*, 945 F.3d at 137–40 (finding no constitutional issue with a bankruptcy judge's jurisdiction to issue third-party releases when the releases are “integral” to the debtor's restructuring); *Blixseth*, 961 F.3d at 1081–82 (permitting narrow exculpation of post-petition acts by parties related to the plan approval process); *In re Le Centre on Fourth*, 17 F.4th at 1334 (finding notice for nondebtor release sufficed for due process purposes).

10. I have made these arguments in a somewhat different form in an amicus curiae brief. Amicus Curiae Brief of Professor Adam J. Levitin at 5–24, *In re Purdue Pharma L.P.*, No. 22-110 (2d Cir. Mar. 18, 2022), ECF No. 625.

11. Thomas E. Plank, *The Erie Doctrine and Bankruptcy*, 79 NOTRE DAME L. REV. 633, 674–75 (2004) [hereinafter Plank, *The Erie Doctrine and Bankruptcy*] (concluding that all nondebtor releases are outside the scope of the Bankruptcy Clause); Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1091–92 (2002) [hereinafter Plank, *Bankruptcy and Federalism*] (describing the Bankruptcy Clause as containing a “non-expropriation principle” that limits bankruptcy law from going beyond adjustment of the debtor-creditor relationship); see also Sergio Campos & Samir D. Parikh, *Due Process Alignment in Mass Restructurings*, 91 FORDHAM L. REV. 325 (2022) (acknowledging bankruptcy's due process infirmities and proposing changes to minimize the risk of future victims unwinding settlements).

12. Page Proof Brief for Appellee U.S. Trustee William K. Harrington at 77–84, *In re Purdue Pharma L.P.*, No. 22-110 (2d Cir. Mar. 18, 2022), ECF No. 558.

13. 304 U.S. 64 (1938); see Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 YALE L.J.F. 960, 967–81 (2022). This point is also implicit in Plank, *The Erie Doctrine and Bankruptcy*, *supra* note 11, at 670–76.

14. Amici Curiae Brief of Bankruptcy Law Professors Ralph Brubaker, George W. Kuney, and Bruce A. Markell in Support of Appellants at 29–30, *In re Purdue Pharma L.P.*, No. 22-110 (2d Cir. Mar. 18, 2022), ECF No. 603.

Southern District of New York has observed that nonconsensual nondebtor releases, while allowed in “extraordinary cases where a particular release is essential and integral to the reorganization itself,” are inconsistent with the requirements of subject-matter and personal jurisdiction, as well as with the Due Process Clause.¹⁵

This Essay’s contribution is an argument that the Constitution precludes most—but not all—nondebtor releases. Departing from previous work, it lays out the core constitutional authority argument in a concise and comprehensive fashion, rather than as an ancillary observation in work focused on different questions. In particular, it probes the original meaning of the Bankruptcy Clause using different sources than those used by Professor Plank to understand the scope of Congress’s power to legislate the relationships between creditors and nondebtors. The Essay also advances a novel argument about the way in which the Article III jurisdiction of federal courts precludes releases of creditors’ claims against nondebtors that have not yet ripened sufficiently to support immediate litigation.

The Essay has a Gallic division. Part I addresses the power of Congress to legislate on the topic of nondebtor releases. It begins with a discussion of the extent of the Bankruptcy Clause to adjust relationships between creditors and nondebtors. It then turns to the further limitations on nonconsensual releases imposed by the Fifth Amendment’s Due Process Clause.

Part II addresses the power of the federal courts to enter orders approving nondebtor releases. It starts with the question of whether there is Article III jurisdiction over the issues covered by nondebtor releases. It argues that, separate from Bankruptcy Clause and Due Process Clause issues, there is Article III jurisdiction over only a subset of releases, namely those where there is an actual case or controversy. A case or controversy requires either actual, pending litigation or sufficient grounds to maintain a declaratory judgment action¹⁶—namely, proof by the plaintiff that there is an immediate and real injury or threat of future injury caused by the defendants,¹⁷ such as a reasonable apprehension of suit¹⁸ (not just the hypothetical possibility of

15. *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 723–26 (Bankr. S.D.N.Y. 2019).

16. *See Shell Oil Co. v. Amoco Corp.*, 970 F.2d 885, 887–88 (Fed. Cir. 1992) (defining a “controversy” in the context of the Declaratory Judgment Act); *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240 (1937) (noting that the phrase “cases of actual controversy” in the Declaratory Judgment Act refers to the type of “cases” and “controversies” that are justiciable under Article III); *see also MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 126–27 (2007) (reaffirming *Aetna Life*’s interpretation of the Declaratory Judgment Act).

17. *See MedImmune*, 549 U.S. at 127 (announcing a totality-of-the-circumstances test for the existence of an “actual controversy” for purposes of declaratory judgment); *Prasco, LLC v. Medicis Pharm. Corp.*, 537 F.3d 1329, 1339 (Fed. Cir. 2008) (interpreting *MedImmune* as requiring “real and immediate injury or threat of future injury that is caused by the defendants”). Virtually all of the jurisprudence on what constitutes an “actual controversy” for purposes of seeking declaratory judgment exists in the patent law context, raising questions of its application more broadly.

18. *Caraco Pharm. Lab’ys, Ltd. v. Forest Lab’ys, Inc.*, 527 F.3d 1278, 1290–91 (Fed. Cir. 2008) (noting that reasonable apprehension of being sued is a way of satisfying the *MedImmune* totality-of-the-circumstances test).

future litigation). Next, it addresses the application of the Fifth Amendment's Due Process Clause and argues that the clause overrides any organic power of federal courts—whether as part of equal powers or federal common law-making—to authorize nonconsensual nondebtor releases.

Part III considers the implications of the unconstitutionality of nonconsensual nondebtor releases for consensual releases. It argues that the constitutional concerns surrounding nondebtor releases necessitate a higher threshold of scrutiny for the existence of consent and for certain procedural steps required at a bare minimum to ensure meaningful consent.

In this Essay, I refer solely to “the federal courts,” rather than “the bankruptcy court.” There is a separate constitutional issue about what powers bankruptcy judges—non-Article III judges—can exercise,¹⁹ but for the purposes of the questions I consider here, it is irrelevant. The powers and jurisdiction of the bankruptcy court are entirely derivative of those of the federal district courts. There is no constitutional requirement for the existence of bankruptcy courts. Bankruptcy cases are technically filed in the federal district court and referred to the bankruptcy court on a standing reference order,²⁰ but the district court may always “withdraw the reference” and hear the case itself. Accordingly, the powers being considered here are those of the federal district court, which will be either coterminous with or greater than those of the bankruptcy court.

I. CONSTITUTIONAL LIMITS ON CONGRESSIONAL AUTHORITY FOR NONDEBTOR RELEASES

A. *The Limited Scope of the Bankruptcy Clause*

The sole font of authority for bankruptcy law in the United States is the Bankruptcy Clause of the Constitution. It provides that “[t]he Congress shall have Power . . . [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States.”²¹ While the Bankruptcy Clause does not spell out the content of what such uniform laws might be, when interpreting the clause, the Supreme Court tends to focus on its original meaning.²²

An original understanding of the Bankruptcy Clause necessarily precludes nonconsensual nondebtor releases. There is no evidence for uses of nonconsensual nondebtor releases before the unsuccessful attempts in the

19. See, e.g., *Lynch v. Lapidem Ltd. (In re Kirwan Offs. S.À.R.L.)*, 592 B.R. 489, 503 (Bankr. S.D.N.Y. 2018); *In re Millennium Lab Holdings II, LLC*, 945 F.3d 126, 140–44 (3d Cir. 2019).

20. 28 U.S.C. §§ 157(a), 1334.

21. U.S. CONST. art. I, § 8, cl. 4.

22. See *Allen v. Cooper*, 140 S. Ct. 994, 1002–03 (2020) (discussing the scope of bankruptcy jurisdiction “at the Founding”); *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356, 362, 370 (2006) (“It is appropriate to presume that the Framers of the Constitution were familiar with the contemporary legal context when they adopted the Bankruptcy Clause . . .”).

1930s.²³ The practice only began to become accepted by some courts following the confirmation order on the Johns-Manville Chapter 11 plan in 1986.

The concept of a nonconsensual nondebtor release in bankruptcy would have been incomprehensible to the Framers. As one scholar noted, the “‘subject of Bankruptcies’ in the Bankruptcy Clause is limited to the adjustment of the relationship between an insolvent debtor and [the debtor’s] creditors.”²⁴ Likewise, as another scholar explained, the Bankruptcy Clause is not a limitless source of authority for courts to authorize any action that might benefit the debtor’s financial condition: “For example, though the chief liability of the bankrupt is thought to be his wife, the bankruptcy court cannot strike at the root of his financial troubles by granting him a divorce—and it is unlikely that Congress, under the Bankruptcy Clause, could authorize the court to do so.”²⁵

How the Framers would have understood the Bankruptcy Clause may be gleaned from the provisions of English bankruptcy law in 1789, from Blackstone’s *Commentaries*, and from the first American bankruptcy statute, the Bankruptcy Act of 1800,²⁶ which was “a faithful transcript of the English statutes.”²⁷ What is clear from these sources is that bankruptcy law, as understood in the Anglo-American world in the eighteenth century, contained four features relevant to the instant issue:

- (1) the law applied solely to the debtor, who was required to have committed a defined act of bankruptcy;²⁸
- (2) *all* of the debtor’s assets were required to be made available for distribution to creditors;²⁹

23. See, e.g., *Weber v. Diversey Bldg. Corp. (In re Diversey Bldg. Corp.)*, 86 F.2d 456, 457–58 (7th Cir. 1936) (district court lacked power to release nondebtor guarantor under a bankruptcy plan); *In re Nine N. Church St., Inc.*, 82 F.2d 186, 188–89 (2d Cir. 1936) (district court lacked power to enjoin suits against nondebtor guarantor). In *Stoll v. Gottlieb*, 305 U.S. 165 (1938), for example, the Supreme Court upheld a challenge to a plan that included a nondebtor release but did so on res judicata grounds and assumed that the bankruptcy court lacked subject-matter jurisdiction to grant the nondebtor release. *Id.* at 171. Notably, no reported cases prior to *In re Johns-Manville* involved an attempt to release a nondebtor party other than a guarantor, and even *In re Johns-Manville* was primarily about the release of insurers—that is, parties that agreed to indemnify the debtor—rather than the releases of parties for their direct liability.

24. Plank, *Bankruptcy and Federalism*, *supra* note 11, at 1089.

25. Alfred Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013, 1037–38 (1953).

26. Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

27. F. REGIS NOEL, A HISTORY OF THE BANKRUPTCY LAW 124 (1919).

28. See, e.g., 2 WILLIAM BLACKSTONE, COMMENTARIES *477–79; Act of Apr. 4, 1800 § 1. Today, the filing of a voluntary bankruptcy petition functions as the “act of bankruptcy.” See Act of Mar. 2, 1867, ch. 176, § 11, 14 Stat. 517, 521 (repealed 1878) (filing of voluntary bankruptcy petition is deemed an act of bankruptcy).

29. See, e.g., Act of Apr. 4, 1800 § 5 (entirety of assets); *id.* § 13 (debts owed to the debtor); *id.* § 14 (concealed property); *id.* § 17 (fraudulently conveyed assets).

- (3) creditors had extraordinary rights of discovery against the debtor in order to ferret out concealed assets;³⁰ and
- (4) the debtor—and solely the debtor—was able to obtain a discharge at the end of the process.³¹

The fourth point is the necessary implication of the first three. Bankruptcy comes with extraordinary burdens—transparency and making available all assets to creditors. Those burdens fall solely on the debtor. Accordingly, it is only the debtor that is freed from the debt upon passing through the ordeal. This is the bankruptcy bargain—discharge (and a fresh start) in exchange for full surrender of current assets.

Even from the first days of the Republic, limits of the scope of this bargain were clearly articulated. The primary form of business organization in the early Republic (besides the ubiquitous sole proprietorship) was the partnership.³² This was not the statutory limited liability partnership common today, but a general partnership in which partners were jointly liable for all the partnership's debts.³³ There is no closer sort of business relationship than that which arises from this joint liability. And yet, the Bankruptcy Act of 1800 expressly provided that—contrary to the traditional common-law rule³⁴—if the debtor was a partner in a partnership, the discharge of the debtor would have no effect on the joint liability of the debtor's partners for partnership debts.³⁵ Similar provisos also appear in the Bankruptcy Act of 1841,³⁶ the Bankruptcy Act of 1867,³⁷ and the Bankruptcy Act of 1898.³⁸

30. See, e.g., BLACKSTONE, *supra* note 28, at 482 (“The bankrupt [sic], upon this examination, is bound upon pain of death to make a full discovery of all his estate”); Act of Apr. 4, 1800 § 18 (submission to examination by creditors); *id.* § 19 (creditors’ right to search all of the bankrupt’s property, including by breaking doors and locks); *id.* § 22 (access to debtor’s books and records). No spousal privilege was admitted regarding bankrupts. BLACKSTONE, *supra* note 28, at 481; Act of Apr. 4, 1800 § 24. The examination was so searching that American law even paid bounties to those who discovered concealed property of the debtor. See *id.* § 26.

31. See, e.g., Act of Apr. 4, 1800 § 34; 5 Geo. 2, c. 30, § 7 (1732) (Eng.).

32. Frederick G. Kempin, Jr., *Limited Liability in Historical Perspective*, 4 AM. BUS. L. ASS’N BULL. 11, 14 (1960).

33. See *id.* at 16 n.25 (noting that the first American limited partnership act was only enacted in 1822).

34. Ralph Brubaker, *An Incipient Backlash Against Nondebtor Releases? (Part I): The “Necessary to Reorganization” Fallacy*, BANKR. L. LETTER, Feb. 2022, at 1, 5.

35. Act of Apr. 4, 1800 § 34; see also *Tucker v. Oxley*, 9 U.S. (5 Cranch) 34, 37, 40 (1809) (discussing provision); *Sleech’s Case*, 1 Mer. 539 (Ch. 1816) (Eng.) (discussing provision).

36. Act of Aug. 19, 1841, ch. 9, § 4, 5 Stat. 440, 443–44 (repealed 1843).

37. Act of Mar. 2, 1867, ch. 176, § 33, 14 Stat. 517, 533 (repealed 1878) (“[N]o discharge granted under this act shall release, discharge, or affect, or discharge any person liable for the same debt for or with the bankruptcy, either as a partner, joint contractor, indorser, surety, or otherwise.”); see also *id.* § 36 (in bankruptcy of partnership, each partner’s discharge is independent). The Supreme Court interpreted section 33 of the act as not preventing creditors from obtaining a post-discharge judgment against the debtor in order to execute on the debtor’s guarantors. *Hill v. Harding*, 130 U.S. 699, 703–04 (1889).

38. Act of July 1, 1898, ch. 541, § 16, 30 Stat. 544, 550 (repealed 1978) (noting that discharge of a debtor does not affect the liability of a codebtor, guarantor, or surety).

Although it might be argued that such provisos were necessary because it was not self-evident that the Bankruptcy Clause was limited to a discharge of the debtor, the more plausible reading is that these were precatory provisions intended to preclude any possible argument that the debtor's partner could benefit from the bankruptcy. Thus, William Cooke's 1785 English treatise, *A Compendious System of the Bankrupt Laws*, did not even discuss the possibility of a discharge for a nonbankrupt partner in the treatise's section on partners of the bankrupt, as it seems that the issue had not arisen in any reported English case.³⁹ Notably, however, Cooke's treatise observed that "allowing the [discharge] certificate of a bankrupt will not discharge [the] sureties" of the bankrupt.⁴⁰ In other words, English bankruptcy law, at the time of the Founding, did not contemplate a discharge for nondebtors, even those who were co-liable with the debtor.

In short, bankruptcy relief as understood by the Framers—and indeed universally prior to the 1980s—would have been limited solely to the debtor and would have been premised on submission to a searching and invasive examination, as well as the surrender of all the debtor's assets. The Framers would not have been able to conceive of a bankruptcy resulting in the forced release of creditors' claims against nondebtors. Those nondebtors could not get a release of liability through the bankruptcy process because those nondebtors had not themselves committed acts of bankruptcy, submitted themselves to examination, and made all their assets available to creditors. The fundamental element of bankruptcy law—the discharge of debts—has always been premised on a party's submission to the jurisdiction of the bankruptcy process and its substantial burdens.

This original understanding of the Bankruptcy Clause indicates that Congress lacks the constitutional power to authorize any releases—whether consensual or nonconsensual—of nondebtors' direct liability through the bankruptcy process.⁴¹ Any reading of the Bankruptcy Clause that does not limit the scope of Congress's power to provide relief to the debtor risks transforming the Bankruptcy Clause from a narrow and particular power of Congress into the equivalent of a second Necessary and Proper or Commerce Clause that would allow Congress the free-ranging power to restructure all manner of economic and property relationships as it sees fit. Given the scant discussion of bankruptcy in the constitutional debates, it is hard to believe that the Framers hid a general power of economic regulation within the modest trappings of the Bankruptcy Clause. Accordingly, it does not matter which *statutory* provision one points to as a purported source of authority for

39. See WILLIAM COOKE, *A COMPENDIOUS SYSTEM OF THE BANKRUPT LAWS* (1786).

40. *Id.* at 343–44.

41. A consensual release does not in fact depend on its inclusion in a bankruptcy plan, but its inclusion in a plan is permitted because it is simply an "appropriate provision not inconsistent with the applicable provisions" of the Bankruptcy Code. See 11 U.S.C. § 1123(b)(6). Whether the Bankruptcy Clause authorizes Congress to permit the release of nondebtors' derivative liability—such as is provided for by 11 U.S.C. § 524(g)—and what liability is in fact derivative are separate questions. See *Travelers Indem. Co. v. Bailey*, 557 U.S. 137 (2009) (limiting nondebtor release under § 524(g) to claims of derivative liability).

nondebtor releases because any such provision—including those under Bankruptcy Code § 524(g)'s asbestos-specific regime⁴²—would appear to be beyond the scope of Congress's constitutional power. Notably, as addressed in Part II, the lack of congressional authority to provide for nondebtor releases by statute does not preclude nondebtor releases under the organic powers of the federal courts, but the authorization of such releases is subject to a different analysis.

B. Fifth Amendment Limitations on the Bankruptcy Clause

The Bankruptcy Clause would appear to preclude congressional authorization of any nondebtor releases, but even if it does not, the power of Congress to adjust liabilities under the Bankruptcy Clause is also constrained by the Fifth Amendment's guaranty of due process of law and prohibition on the taking of private property without just compensation.⁴³

The Due Process Clause does not preclude consensual releases of nondebtors. Nonconsensual nondebtor releases, however, offend due process for two reasons⁴⁴: First, such nonconsensual releases are undertaken without opportunity for an adjudication of the creditors' claims against nondebtors. Second, the releases are nonconsensual deprivations of property. At the core of due process is notice and the opportunity for an adjudication of a claim on its merits before a competent tribunal. As the Supreme Court has noted:

Many controversies have raged about the cryptic and abstract words of the Due Process Clause but there can be no doubt that at a minimum they require that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case.⁴⁵

To be sure, the particulars of the adjudication may vary based on the circumstances involved.⁴⁶ Nevertheless, “[t]he essence of due process is the requirement that ‘a person in jeopardy of serious loss [be given] notice of the case against him and opportunity to meet it.’”⁴⁷ Notice alone is not sufficient

42. 11 U.S.C. § 524(g).

43. See Hill, *supra* note 25, at 1038 (“[T]he bankruptcy power is restricted . . . by other provisions in the Constitution, such as the Due Process Clause . . .”).

44. Two additional, but potentially surmountable, due process issues also exist with nondebtor releases: the adequacy of notice provided to creditors of the releases and the adequacy of representation of future claimants in the bankruptcy process.

45. Mullane v. Cent. Hanover Bank & Tr. Co., 339 U.S. 306, 313 (1950); see also Fuentes v. Shevin, 407 U.S. 67, 80–81 (1972) (requiring notice and opportunity to be heard prior to replevin of goods); Sniadach v. Fam. Fin. Corp., 395 U.S. 337, 340–42 (1969) (requiring notice and an opportunity to be heard prior to wage garnishment order).

46. See, e.g., Mathews v. Eldridge, 424 U.S. 319, 348–49 (1976).

47. *Id.* (second alteration in original) (quoting Joint Anti-Fascist Comm. v. McGrath, 341 U.S. 123, 171–72 (1951) (Frankfurter, J., concurring)).

due process.⁴⁸ Due process also prohibits parties from being deprived of property without getting their proverbial “day in court” in some form.⁴⁹

Nonconsensual nondebtor releases are inconsistent with such due process requirements. Creditors who have direct claims against nondebtors have property interests: their direct claims are “choses in action.” Like other types of property interests, these choses in action are protected under the Due Process Clause.⁵⁰ Moreover, these choses in action also clearly have value: nondebtors’ contribution to a plan, including their own granting of mutual releases, is contingent on their release from the direct claims.

The confirmation order for a plan with a nonconsensual nondebtor release effectuates the forced release of creditors’ covered direct claims against nondebtors. This happens without any opportunity for adjudication of individual direct claims whatsoever. Creditors compelled into nonconsensual nondebtor releases never get their chance at a “day in court” vis-à-vis the nondebtor. At most, they get to appear in the bankruptcy case, but the released claims are not claims against the debtor, but against a party over which the court might not even have jurisdiction.

There is no way to reconcile this with the demands of due process. Creditors’ direct claims have never been adjudicated in any fashion by any court. Even if a court had jurisdiction over these direct claims (addressed below), no complaint for these direct claims has been filed before a court, no answer has been provided, no motion practice has occurred nor discovery been taken, and no facts have been found by a trier of fact regarding these direct claims. Simply put, there is nothing before the court to adjudicate, so no adjudication is possible.

48. See *City of New York v. N.Y., N.H. & H.R. Co.*, 344 U.S. 293, 297 (1953) (noting it is a “basic principle of justice . . . that a reasonable opportunity to be heard must precede judicial denial of a party’s claimed rights”).

49. See *Martin v. Wilks*, 490 U.S. 755, 761–62, 768 (1989) (noting the “deep-rooted historic tradition that everyone should have his own day in court” and that “[a] voluntary settlement . . . cannot possibly settle, voluntarily or otherwise, the conflicting claims of [those] who do not join in the agreement” (internal quotation marks omitted)). The Fifth Amendment Due Process Clause’s “day in court” requirement stands separate and apart from the Fifth Amendment’s prohibition on takings without just compensation. Even if there has been an adjudication, the creditor must also be paid just compensation for its claim. What “just compensation” means in the context of bankruptcy is beyond the scope of this Essay, but presumably, just compensation takes the form of a bankruptcy claim with a face amount equal to the value of the property taken, rather than a distribution in bankruptcy equal to the value of the property taken. If so, the prohibition on takings without just compensation could likely be satisfied if a creditor were to receive—specifically on account of the release of the nondebtor—an appropriately extra or larger claim in the bankruptcy. This would, however, require a finding by the court regarding the extra distribution to the creditor being on account of the release.

50. See, e.g., *Tulsa Pro. Collection Servs., Inc. v. Pope*, 485 U.S. 478, 485 (1988) (“Little doubt remains that [a cause of action] is property protected by the Fourteenth Amendment.”); *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 807 (1985) (“[A] chose in action is a constitutionally recognized property interest possessed by each of the plaintiffs.”); *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 428 (1982) (“[A] cause of action is a species of property protected by the Fourteenth Amendment’s Due Process Clause.”); *Mullane*, 339 U.S. at 313 (recognizing cause of action as property interest).

Nor could a Chapter 11 plan confirmation process function as an adjudication. A court's findings of fact in a plan confirmation order all relate to whether the *debtors* have met the statutory requirements for Chapter 11 plan confirmation. A bankruptcy court has no basis for making findings of fact regarding the merits of individual creditors' direct claims. Likewise, the percentages of creditors supporting a plan are irrelevant—due process rights are not subject to majority vote. The Chapter 11 plan confirmation procedures are not themselves any sort of due process for the direct claims. Accordingly, nondebtor releases violate the Fifth Amendment because they deprive creditors of property without due process of law.⁵¹

Nonconsensual nondebtor releases also violate the Fifth Amendment's Due Process Clause for another reason: they are nonconsensual. The Supreme Court has made clear that in the context of a monetary damages class action under Federal Rule of Civil Procedure Rule 23(b)(3), due process requires, at a minimum, the opportunity to opt out of a class.⁵² Bankruptcy is not meant to be a back door for bypassing the constitutional strictures that govern class actions.

To be sure, a class action involving a limited fund under Federal Rule of Civil Procedure Rule 23(b)(1) does not require an opt-out opportunity, but there is no limited fund in the case of nondebtor releases. The debtor in bankruptcy is, of course, a classic limited fund situation—a major function of bankruptcy law is to provide an orderly mechanism for dividing a limited fund. But the *nondebtor* that benefits from a release is not a limited fund. The nondebtor has never had to open its books for inspection under penalty of law. When nondebtor releases are approved, there is never a court finding sufficient to establish the existence of a limited fund, which would require not just a finding about the extent of the nondebtor's assets, but also a finding that all those assets are being committed to satisfying creditors' claims. To

51. Nondebtor releases are also uncompensated takings. See *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 725–26 (Bankr. S.D.N.Y. 2019) (noting that “[i]nvoluntary releases also result in a taking of property without a formal hearing to ensure that the affected party has received proper compensation”). The Fifth Amendment prohibits takings of property for public purposes without just compensation. U.S. CONST. amend. V. Nondebtor releases force creditors to surrender property—a chose in action—without any determination that they have received just compensation. Indeed, the findings of fact that typically support a release do not distinguish whether the distribution to a creditor is on account of the release or on account of its claim against the debtor. Notably, even if there were just compensation, that would only satisfy the takings issue; the due process issue would remain even if the compensation were just.

52. *Wal-Mart Stores, Inc. v. Dukes*, 564 U.S. 338, 363 (2011) (“In the context of a class action predominantly for money damages we have held that absence of notice and opt out violates due process.”); *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 846–48 (1999) (noting the due process problem of a mandatory class in a class action for damages). The Supreme Court has held the same in the context of a state law class action. *Shutts*, 472 U.S. at 812 (“[D]ue process requires at a minimum that an absent plaintiff be provided with an opportunity to remove himself from the class . . .”). Whether consent in bankruptcy would require an opt-in rather than an opt-out right is an issue that has divided lower courts. See generally Dorothy Cocco, *Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law*, 88 *FORDHAM L. REV.* 231 (2019) (discussing various approaches to consent in the context of nondebtor releases).

the extent that a nondebtor is not committing all its assets to satisfy creditors' claims, the "fund" is not in fact limited, as additional funds remain available to satisfy creditors' claims. It does not matter that those additional funds are themselves finite because they are not actually threatened with depletion. Until the actual limitations of the "fund"—that is, the nondebtor's ability to pay, not its willingness to pay—are at issue, there is no economically limited fund.

The Due Process Clause applies to bankruptcy cases just as it does to class actions, and it requires that any settlement of claims against nondebtors be consensual. All nonconsensual nondebtor releases violate the Fifth Amendment.

II. CONSTITUTIONAL LIMITS ON COURTS' AUTHORITY TO ENTER NONCONSENSUAL NONDEBTOR RELEASES

A. Article III Jurisdiction "Case or Controversy" Requirement

Article III extends the federal judicial power solely to "cases" and "controversies."⁵³ It is axiomatic that a case or controversy requires either that litigation has actually been brought or there is an immediate and real injury or threat of future injury that would permit a court to issue a declaratory judgment about a dispute.⁵⁴ Typically, this second circumstance requires the party seeking a declaratory judgment to prove a reasonable apprehension of being sued.⁵⁵ Unless one of these two conditions has been met, there is nothing for the court to adjudicate.

The requirement of actual litigation or injury sufficient for a declaratory judgment action makes sense because it requires the parties to be able to articulate the claim to be adjudicated with sufficient definiteness. Without that, the court—and the parties—could not know what was actually being adjudicated and whether it actually falls into the ambit of the court's jurisdiction. Nor could other courts determine the preclusive effect of any judgment.

This jurisdictional limitation means that if the creditor has not yet brought suit against the nondebtor, or if the nondebtor could not yet sustain a declaratory judgment action because its dispute with the creditor was not sufficiently immediate and real, federal courts lack jurisdiction to enter an order releasing the creditor's claim against the nondebtor because there is no

53. U.S. CONST. art. III, § 2.

54. See *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007) (announcing a totality-of-the-circumstances test for the existence of an "actual controversy" for purposes of declaratory judgment); *Prasco, LLC v. Medicis Pharm. Corp.*, 537 F.3d 1329, 1339 (Fed. Cir. 2008) (interpreting *MedImmune* as requiring "real and immediate injury or threat of future injury that is caused by the defendants").

55. See *Caraco Pharm. Lab'ys, Ltd. v. Forest Lab'ys, Inc.*, 527 F.3d 1278, 1290–91 (Fed. Cir. 2008) (noting that reasonable apprehension of being sued is a way of satisfying the *MedImmune* totality-of-the-circumstances test).

“case” or “controversy” to adjudicate.⁵⁶ If a creditor merely has a *potential* claim against the nondebtor, but has not yet sued or taken actions that would threaten to harm the nondebtor (for example, perhaps demanding payment or threatening suit), federal courts lack Article III jurisdiction to resolve that potential claim until it ripens sufficiently to sustain a suit brought by the claimant or a declaratory judgment action brought by nondebtor. Article III jurisdiction would have to exist for each individual creditor affected by the nondebtor release.

It is important to note that recognition of the limitation on federal courts’ constitutional jurisdiction to actual “cases” and “controversies” need not affect the ability of bankruptcy law to address contingent and unmatured claims against the debtor. The objection to a claim filed by a creditor or scheduled by the debtor should function like a complaint for the purposes of bringing the matter within the scope of Article III.

The implication of Article III’s limitation on federal court jurisdiction to actual “cases” and “controversies” means that federal courts lack jurisdiction to address creditors’ unripened claims against nondebtors, separate and apart from the Bankruptcy Clause and Due Process Clause issues with releases.⁵⁷ Federal courts have, *at most*, jurisdiction over a very limited subset of creditor claims against nondebtors, namely those where a suit is pending or could be pending at the time of the entry of a plan confirmation order. They do not have jurisdiction over future claims that might be brought against nondebtors.

56. A similar problem exists under the statute on bankruptcy subject-matter jurisdiction. That statute provides that “the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.” 28 U.S.C. § 1334(b). Any subject-matter jurisdiction over creditors’ claims against nondebtors would likely be under the third “related to” prong. The statute on bankruptcy subject-matter jurisdiction, however, limits jurisdiction to “civil proceedings . . . related to cases under title 11.” *Id.* Even if a creditor’s claim against a nondebtor were related to the bankruptcy case, there is still no federal subject-matter jurisdiction unless there is an actual pending suit—a “civil proceeding[]”—brought by the creditor against the nondebtor. *Id.* Indeed, one court has observed: “[W]hen third-party releases are proposed there is rarely any ‘proceeding’ pending at all. Instead, the court is asked to exercise power over a potential claim for which no actual proceeding exists.” *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 723 (Bankr. S.D.N.Y. 2019). The “civil proceeding” constraint on statutory jurisdiction is more restrictive than the Article III “case” or “controversy” requirement. “Controversy” is broad enough to encompass situations where a suit is reasonably anticipated and can create the basis for a party seeking a declaratory judgment. *See supra* note 16 and accompanying text. The use of the term “proceeding” and the statutory requirement of a “civil proceeding” restrict subject-matter jurisdiction to actual cases (and would further exclude criminal cases). Notably, when the Supreme Court addressed the scope of bankruptcy “related to” subject-matter jurisdiction under 28 U.S.C. § 1334(b), it was in the context of *pending* civil litigation, so the “civil proceedings” limitation never arose. *Celotex Corp. v. Edwards*, 514 U.S. 300, 301–02 (1995) (addressing jurisdiction over execution on supersedeas bond on judgment).

57. Professor Marcus G. Cole has argued that future claims should not be subject to nondebtor releases on the basis of federalism concerns, the Bankruptcy Code’s requirement of equal treatment with present claimants, and distorted incentives for voting. Marcus G. Cole, *A Calculus Without Consent: Mass Tort Bankruptcies, Future Claimants, and the Problem of Third-Party Nondebtor “Discharge,”* 84 IOWA L. REV. 753, 778–95 (1999).

B. Fifth Amendment Limitations on the Courts' Organic Powers

Even when Article III jurisdiction exists, federal courts must still have some source of authority to issue nondebtor releases. Part I of this Essay explained why the Bankruptcy Code cannot be the source of such authority—the Bankruptcy Clause and the Due Process Clause each independently preclude Congress from authorizing nonconsensual nondebtor releases.

Federal courts, however, have organic, extra-statutory lawmaking powers, although the nature and scope of such powers is often a matter of some controversy. Disputes about the nature and ambit of these powers are irrelevant in this context, however. No matter whether the federal courts' organic powers are characterized as rooted in federal common law-making or equity powers,⁵⁸ they are all necessarily bounded by the Fifth Amendment, which is a limitation on the entire federal government, not merely on Congress. Just as the Fifth Amendment precludes Congress from legislating a process whereby creditors can be deprived of their property rights against nondebtors without an adjudication, so too does it prevent courts from doing this on their own. Nonconsensual nondebtor releases are beyond the power of federal courts.

The Fifth Amendment does not preclude consensual releases of nondebtors as part of a bankruptcy plan, however. Such releases are potentially within the power of federal courts. Substantively, however, the inclusion of consensual releases in a bankruptcy plan does little more than create a convenient procedural vehicle for the aggregate solicitation and tabulation of releases that are individually possible on a private, bilateral basis outside of bankruptcy.

Whether federal courts' organic powers extend so far as to cover the actual consensual releases contemplated is likely a case-specific issue, as such releases would also have to have a sufficient connection to the bankruptcy case for the bankruptcy court to have statutory subject-matter jurisdiction, but if the release implicates the property of the bankruptcy estate, such jurisdiction would surely exist.

III. THE NEED FOR STRICT SCRUTINY OVER NONDEBTOR RELEASES

A. Where Nondebtor Releases May Still Be Constitutional

To put together the limitations distilled by the previous parts of this Essay, although Congress lacks the power to authorize any sort of nondebtor release, the federal courts have the power to authorize *consensual* releases of ripened claims of creditors against nondebtors as part of a bankruptcy plan.⁵⁹

58. See, e.g., Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1 (2006) (arguing that federal courts' exercise of organic powers in bankruptcy is best conceived of as rooted in federal common law-making, rather than in powers of equity).

59. See *supra* Table 1.

Although nonconsensual nondebtor releases are beyond the constitutional power of federal courts, consensual releases—bilateral settlements between creditors and nondebtors—are permitted, although there must still be a subject-matter basis for a federal court to hear the case, such as the involvement of the property of the bankruptcy estate, the estate's own claims, or the existence of indemnification or contribution claims on the estate by nondebtors.

Notably, previous scholarship arguing that nondebtor releases are beyond the organic lawmaking power of federal courts has focused on nonconsensual releases, rather than on the possibility of limited authority for consensual releases.⁶⁰ Whether federal courts' organic powers do in fact extend so far is a question beyond the scope of this Essay.

B. Strict Scrutiny over Consent and Jurisdiction

The unconstitutionality of nonconsensual nondebtor releases places great pressure on proponents of those releases—and courts that see such releases as a useful tool for facilitating majoritarian reorganization deals—to cast releases as consensual and to claim jurisdiction based on the releases involving the interests of the bankruptcy estate.

The constitutional concerns involved with nondebtor releases should mandate a higher level of scrutiny over such supposedly consensual releases. In terms of consent, this means undertaking serious scrutiny of the adequacy of notice and the form of consent.⁶¹ Particularly in the case of mass tort plaintiffs, opt-in consent should be preferred to opt-out consent. Creditors are not required to vote in Chapter 11, and their inaction is hardly evidence of affirmative consent. Waiver of constitutional rights should not be implied.

To be sure, there is no higher standard of scrutiny for consent in the context of class actions under Federal Rule of Civil Procedure Rule 23(b), which allow opting out. The class action opt-out situation may be distinguished from consent to the nondebtor releases in a bankruptcy plan because the class action consent is consent on a stand-alone issue, whereas the bankruptcy release is always in the context of a vote on a plan. The combination of the plan solicitation and the release solicitation means that the plan solicitation is likely to overshadow the release. While there might be a separate consent solicitation on the ballot, the creditor has received an extensive disclosure statement about the debtor and its plan, and the release of nondebtors will be addressed only in the bowels of that disclosure statement, rather than being the subject of a freestanding disclosure and solicitation. Procedurally, bundling the plan solicitation with the release solicitation makes creditor comprehension and consent to the release more suspect.

Courts should also be wary of arguments that the estate's interests are implicated because of the released nondebtor's indemnification and

60. See Plank, *The Erie Doctrine and Bankruptcy*, *supra* note 11, at 670–76; Brubaker, *supra* note 13.

61. See generally Plank, *The Erie Doctrine and Bankruptcy*, *supra* note 11, at 676–77 n.220 (discussing problem of deemed consent).

contribution claims against the estate.⁶² Such arguments are key for establishing statutory subject-matter jurisdiction, but courts should be suspicious of arguments based on indemnification and contribution claims because such claims should properly be disallowed under 11 U.S.C. § 502(e)(1) in most cases, might also be subject to equitable subordination under 11 U.S.C. § 510(c), and would likely be dischargeable in any event. The number and magnitude of claims against the estate does not implicate the property of the estate—only its division. Nonetheless, if the debtor in possession has not sought to disallow or subordinate such claims, it should not be allowed to use the continued vitality of such claims as a basis for bringing a settlement within the jurisdiction of the bankruptcy court.

Similarly, courts should be leery of claims to jurisdiction if such jurisdiction is claimed over a creditor's settlement with a nondebtor because the settlement is a package deal that settles both the creditor's claims and the debtor's own claims against the nondebtor. Unless the debtor's own claims truly cannot be separated from those of the creditors, this sort of arrangement should not be allowed because it provides a ready fig leaf for entering settlements when Article III jurisdiction is lacking.

For example, a nondebtor might propose making a substantial contribution to a trust for the benefit of particular creditors, but only in exchange for the debtor indemnifying it against certain claims by those creditors. Although such an arrangement might increase the funding available *through the bankruptcy* for the creditors, there is no guarantee that it will maximize the creditors' *total* recoveries, both in and outside of bankruptcy. More critically, the court should decline to exercise jurisdiction in such an obviously manufactured context. The transactions relating to the nondebtor release itself cannot themselves give rise to subject-matter jurisdiction.

CONCLUSION

Nondebtor releases have long been one of the most controversial practices under Chapter 11. Yet there has been curiously little scrutiny of their underlying constitutionality. Instead, the legal debate has focused on whether they are authorized by the Bankruptcy Code or federal courts' organic powers, without consideration of constitutional limits on their scope.

This Essay has presented the case that courts lack the power to order nonconsensual releases of nondebtors, and that even most consensual releases lack validity. The particular provisions of the Bankruptcy Code and federal courts' equity and common law-making powers are simply irrelevant to the question of nonconsensual nondebtor releases, which are anathema to the Bankruptcy Clause, the Due Process Clause, and, in many cases, Article III jurisdiction. Any court that would authorize a nonconsensual nondebtor release should consider whether it has the constitutional power to do so.

62. 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, 1002–09 (arguing that nondebtor releases cannot be justified based on the possibility of indemnification or contribution claims against the estate by the nondebtor).