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Southern District of Texas Upholds Non-Debtor Third-Party Releases Based on Expansive View of Creditor Consent

On February 8, 2019, the United States District Court for the Southern District of Texas, Houston Division, affirmed a Bankruptcy Court order enjoining a claimant from pursuing claims against a debtor's non-debtor affiliates based upon third-party release and injunction provisions included in the debtor's confirmed chapter 11 plan. *In re CJ Holding Co.*, 2019 WL 497728 (S.D. Tex. Feb. 8, 2019). Notably, the District Court concluded that the claimant was bound by the release provisions despite not voting on, or objecting to, the plan on the theory that the claimant's "silence" should be "constru[ed] . . . as consent." *Id.* at *8. The District Court's broad interpretation of consent adds to an inconsistent body of case law related to third-party releases, underscoring the necessity for a stakeholder to actively preserve its rights during the course of a bankruptcy case.

Background

In 2014, John Cole filed a harassment claim with the Equal Employment Opportunity Commission against his employer ("C&J"). In July 2016, C&J and certain affiliates sought chapter 11 relief in the United States Bankruptcy Court for the Southern District of Texas.

In November 2016, Cole requested relief from the automatic stay to pursue litigation or arbitration against C&J. The Bankruptcy Court denied the motion without prejudice. Shortly after filing that motion, Cole sued two non-debtor affiliates of C&J (the "Nabors Entities") in the United States District Court for the Western District of Texas, asserting liability for the same harassment claim against the Nabors Entities as employers under Title VII.

The Debtors eventually filed a plan of reorganization that included third-party release and injunction provisions in favor of non-debtor entities, including non-debtor affiliates. Cole did not file a timely proof of claim and, thus, was not entitled to vote on the plan. Nonetheless, Cole received notice of the plan, which included the third-party release provisions in bold font, and did not object, participate in the confirmation hearing, or appeal the order confirming the plan. The Bankruptcy Court confirmed the plan in December 2016.

In August 2018, the Nabors Entities filed a motion with the Bankruptcy Court seeking to enforce the chapter 11 plan's third-party release and injunction provisions with respect to Cole's claims (*i.e.*, bar Cole from pursuing his District Court action and a related arbitration). The Bankruptcy Court granted the motion.

Cole appealed arguing, among other things, that the Bankruptcy Court lacked jurisdiction to grant the third-party releases.

Claim Preclusion

As an initial matter, on appeal the District Court held that Cole was barred by the doctrine of preclusion from arguing that the Bankruptcy Court lacked jurisdiction to approve the third-party releases because he never raised the argument in the bankruptcy case. The District Court emphasized that Cole was a party to the bankruptcy proceeding and had the opportunity to timely file a proof of claim (and vote on the plan), directly challenge the plan, or raise any challenge to the Bankruptcy Court's jurisdiction over third-party releases. Having failed to do so, he could not challenge the Bankruptcy Court's jurisdiction in a subsequent litigation.

Third-Party Release

The District Court next considered the merits of Cole's jurisdictional arguments. Cole challenged the Bankruptcy Court's jurisdiction to approve the plan's third-party release provisions on three grounds: (i) the Bankruptcy Code categorically prohibits the release of claims against non-debtor entities, (ii) even if such releases are permissible, Cole did not consent to the plan and, therefore, should not be bound by them, and (iii) the Bankruptcy Court did not have subject matter jurisdiction over his claims. The District Court rejected each of these arguments.

Turning to Cole's first argument, the District Court acknowledged that there is a circuit split regarding the scope of a bankruptcy court's power to approve non-debtor third-party releases. The District Court observed, however, that while the Fifth Circuit prohibits *non-consensual* third-party releases, consensual releases are permissible.

The District Court next considered whether Cole had consented to the plan and its non-debtor releases. The District Court adopted an expansive view of the contours of consent, noting that, while the Fifth Circuit has not yet explained what constitutes consent in this context, "[a]llowing the bankruptcy court to approve the Plan releases, including *construing Cole's silence as consent*, serves the bankruptcy law's purpose of quick and efficient resolution of claims to permit a debtor's business to continue." *Id.* at *8 (emphasis supplied). Given Cole's conduct during the bankruptcy proceedings (including his failure to file a proof of claim or participate in the plan process, despite receiving notice), the District Court concluded that the Bankruptcy Court did not err in enforcing the third-party release and enjoining Cole's suit against the Nabors Entities. While Cole maintained that he did not understand the plan because it was "full of complicated legal terms," the District Court was not swayed, noting that "[n]either the Supreme Court nor the Fifth Circuit requires a debtor or a bankruptcy court to help creditors understand a proposed plan." *Id.* at *9.

Finally, the District Court also rejected Cole's assertion that the Bankruptcy Court lacked subject matter jurisdiction to release his claims, reasoning that Cole's claims were "related to" the bankruptcy proceeding because they could have a number of conceivable effects on C&J's bankruptcy estate and arose primarily as a result of C&J's alleged conduct.

Conclusion

Case law on third-party releases varies wildly across, and even within, jurisdictions. Whether other courts in the Fifth Circuit will adopt *CJ Holding Co.*'s expansive view of consent remains to be seen. However, *CJ Holding Co.* highlights the importance of carefully reviewing chapter 11 plans (even if you are not entitled to vote) and taking affirmative steps during the voting and/or plan confirmation process to register opposition to (or support for) third-party releases.

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

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