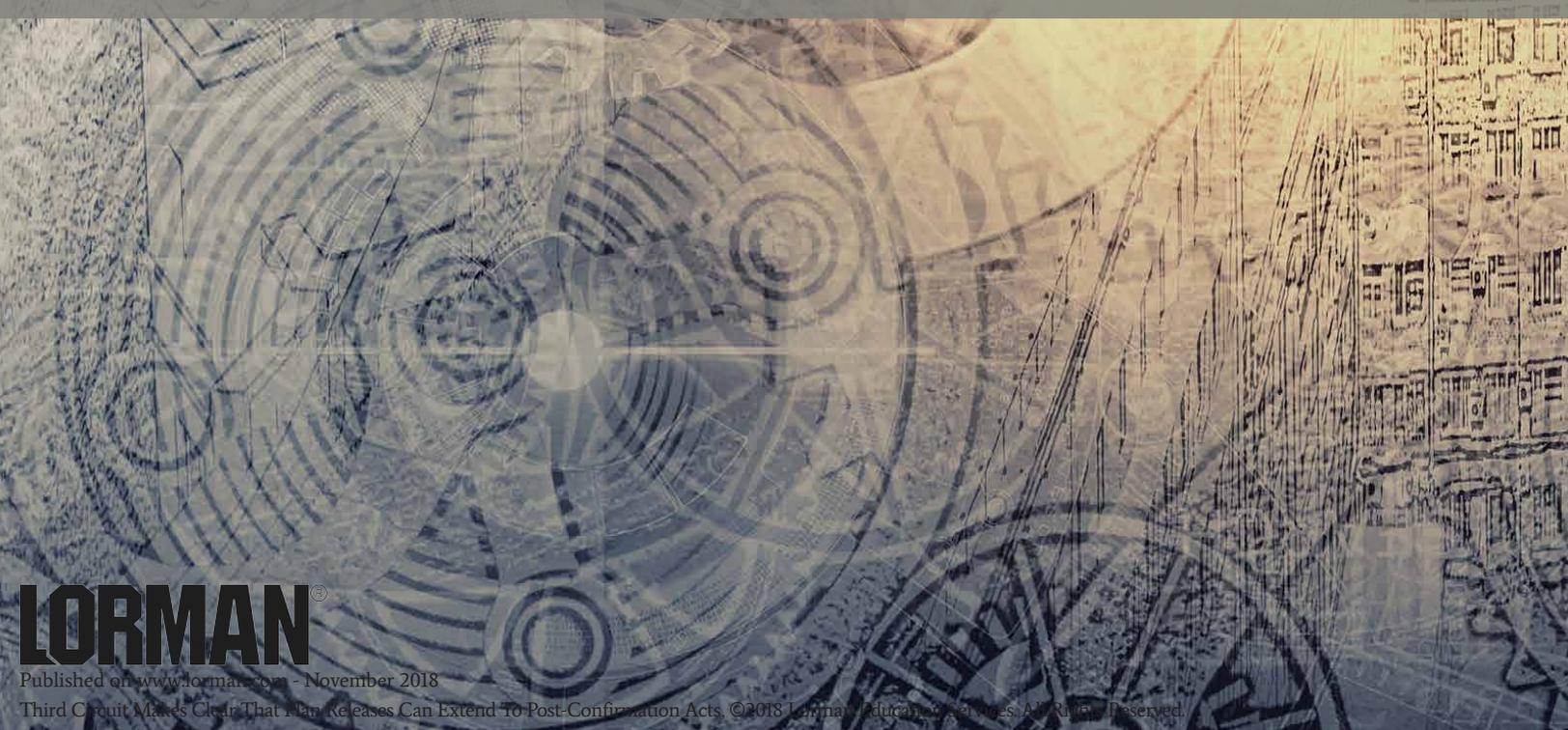




Third Circuit Makes Clear That Plan Releases Can Extend To Post-Confirmation Acts

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Third Circuit Makes Clear That Plan Releases Can Extend To Post-Confirmation Acts

Written by Mark Salzberg - 9/17/18

We have discussed plan releases in prior posts. Oftentimes, disputes involving plan releases revolve around whether, and in what contexts, third-party releases in plans are appropriate. Recently, the Third Circuit Court of Appeals addressed the relatively unique question of whether releases in a confirmed plan are binding upon post-confirmation purchasers of the debtor's stock. The Court's decision in *Arctic Glacier Int'l, Inc.* puts buyers of a debtor's claims and shares on notice that they are bound by the terms of the plan, including third-party release provisions.

Factual Background

In *Arctic Glacier*, the debtors, including Arctic Glacier Income Fund ("Arctic Glacier"), filed for protection under Canada's Companies Creditors' Arrangement Act. The debtors also filed for and received recognition under Chapter 15 of the Bankruptcy Code. Under the debtors' plan of arrangement (the "Plan"), Arctic Glacier was to liquidate and distribute the proceeds to its creditors, giving lowest priority to shareholders. A Monitor appointed under the Plan was empowered to sell and distribute assets with few limitations on when

or how much he could distribute as long as he gave 21 days' notice of any distribution.

The Plan included broad releases of liability and insulated Arctic Glacier and its officers from any claim "in any way related to, or arising out of or in connection with" the bankruptcy. The only exceptions were for claims to enforce the Plan, those for gross negligence or willful misconduct and those whose release was not "permitted by applicable law."

After all creditors had been paid in full, the Monitor gave notice that he was set to distribute dividends to shareholders. None of these notices specified how much the Monitor would distribute or when. Moreover, the Monitor did not notify the Financial Industry Regulatory Authority (FINRA), the organization charged by the Securities and Exchange Commission with regulating distributions on the U.S. Over-the-Counter Market, of his intent to make distribution to shareholders.

Appellants purchased more than 12 million Arctic Glacier shares after the Monitor had given notice of distributions. Appellants' purchases were presumably based upon an assumption that FINRA's rules applied to the Monitor's distributions since under the FINRA rules, Appellants would be entitled to the dividends. However, the Monitor took the position that the FINRA rules were inapplicable and paid the dividends to the original owners of the shares.

Appellants sued Arctic Glacier and four of its officers, claiming that Arctic Glacier owed them the dividends but never paid them. The bankruptcy court dismissed the complaint holding that the releases and the doctrine of *res judicata* barred the suit. The District Court affirmed for the same reasons.

The Third Circuit's Decision

The Third Circuit affirmed the District Court's decision. As an initial matter, the Court held that a confirmation order is the functional equivalent of a final judgment and, like any final judgment, is entitled to *res judicata* effect. In the context of a bankruptcy, the confirmation order is *res judicata* as to all issues decided or which could have been decided at the confirmation hearing. Therefore, the Plan's releases were binding upon Appellants and Appellants cannot now challenge the propriety or enforceability of the releases.

Moreover, the Court rejected Appellants' contention that a plan cannot bar liability for post-confirmation acts. The Court rejected Appellant's reliance on a single sentence at the end of the U.S. Supreme Court's decision in *Holywell Corp. v. Smith*, where the Supreme Court stated that "we do not see how [a confirmed plan] can bind the United States or any other creditor with respect to post[-]confirmation claims." While the Appellants interpreted this sentence to mean that bankruptcy plans can never bar liability for any post-confirmation acts, the Third Circuit held that "*Holywell* lays down no such broad rule" and found that Appellants' argument would effectively gut the enforceability of confirmation orders:

By definition, a debtor can implement its plan only after the bankruptcy court confirms it. And a confirmed plan is a binding plan. So the [Appellant's] overreading of a single sentence in *Holywell* would nullify the *res judicata* effect of confirmed plans and, with it, much of Chapter 11. We do not read *Holywell* that broadly. It casts no doubt on the rule that confirmed plans can bar liability for post-confirmation acts.

Having rejected the argument that the confirmation order was not entitled to *res judicata*, as well as the argument that the Plan's release cannot extend to post-confirmation acts, the Court then found that the Plan's releases barred Appellants' claims. By their terms, the releases extended to all claims arising out of the bankruptcy, including distributions under the Plan. The carve outs for enforcement of the Plan or for gross negligence or willful misconduct were clearly inapplicable to Appellants' claims. Moreover, Appellants did not argue in the lower courts that the FINRA rules fell within the definition of "applicable law" and therefore survived the releases in the Plan. Thus, the issue of whether the "applicable law" carve out applied to Appellants' claims was not before the Third Circuit and the Court expressly refused to rule on that issue.

The Court made short work of Appellants' position that buying shares of stock did not make them transferees, holding that "[t]o state the first argument is to refute it" and that "[b]uying a share of stock is a transfer." Contrary to Appellant's argument, the shares came "with both the Plan's benefits and its burdens", including the releases. Finally, the Court rejected the argument that due process prohibits the application of the releases to Appellants' claims, primarily because of the undisputed fact that Appellants were on notice of the Plan and its release provisions.

Implications

The Third Circuit's decision in *Arctic Glacier* clarifies the preclusive effect of confirmation orders. Confirmation orders are, in essence, final judgments and are *res judicata* as to all matters that were, or that could have been, decided at the confirmation hearing. Further, the Court's decision that post-confirmation purchasers of stock are

subject to the terms of a confirmed plan, including any releases, puts those buying claims and interests on specific notice that they must be fully aware of all plan provisions that may impact their anticipated recoveries under the plan. This includes release provisions and preemption of laws and rules, for instance the FINRA rules which were central to Appellants' arguments. *Arctic Glacier* leaves open the question, at least within the Third Circuit, of whether a plan can preempt the FINRA rules.

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