ALERT MEMORANDUM

# Third Circuit Approves Non-Consensual Third-Party Releases Based on "Exceptional Facts" in *Millennium Lab Holdings II, LLC*

*January 6, 2020*

On December 19, 2019, the U.S. Third Circuit Court of Appeals (the "Third Circuit" or the "Court") issued its decision in *In re Millennium Lab Holdings II, LLC, et al.*,[1] holding that the bankruptcy court had constitutional authority under *Stern v. Marshall*[2] to approve a Chapter 11 plan containing non-consensual third-party releases.

In its opinion, the Court stated that a bankruptcy court has constitutional authority to approve a plan including non-consensual releases when it is exercising its "core" statutory authority and the releases are "integral" to the restructuring. However, the Court limited its decision to the facts of this case and emphasized the intensive negotiations between sophisticated parties, the fact that the releases were "absolutely required" for the reorganization, and that the debtor would have gone into liquidation without the releases. The Court also held that the remaining issues were equitably moot because the confirmed plan was substantially consummated and, as a result of substantial post-confirmation transactions, overturning the releases at this point would "fatally scramble" the confirmed plan and significantly harm third parties who had justifiably relied upon it.


If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors.

NEW YORK

**Lisa M. Schweitzer**
+1 212 225 2629
lschweitzer@cgsh.com

**Sean A. O'Neal**
+1 212 225 2416
soneal@cgsh.com

**Luke A. Barefoot**
+1 212 225 2829
lbarefoot@cgsh.com

**Jane VanLare**
+1 212 225 2872
jvanlare@cgsh.com

**Thomas Lynch**
+1 212 225 2566
tlynch@cgsh.com


The Court made clear that its decision was not intended to extend bankruptcy court authority or allow creditors to engage in "gamesmanship" by demanding releases. The Court emphasized that its prior precedents still apply, which require that, in order to be approved, such releases have "The hallmarks of . . . fairness, necessity to the reorganization, and specific factual findings to support these conclusions."[3] Notwithstanding the Court's emphasis on the facts of this case, the decision provides guidance on when non-consensual third-party releases may meet these standards and the factors a court will consider in deciding whether to approve them.

[1] No. 18-3210 (3d Cir., Dec. 19, 2019).
[2] 564 U.S. 462 (2011).
[3] *In re Millennium*, No. 18-3210, at 12–13.

## Background and Procedural History

Millennium Lab Holdings II, LLC and its wholly-owned subsidiaries (collectively "Millennium") provide laboratory diagnostic and testing services. The primary shareholders of Millennium were TA Millennium, Inc. ("TA") and Millennium Lab Holdings, Inc. ("MLH"). In April 2014, Millennium entered into a credit agreement with various lenders, including Voya Investment Management Co. LLC and Voya Alternative Asset Management LLC (collectively "Voya").

A little less than a year later the Centers for Medicare and Medicaid Services ("CMS") notified Millennium that it intended to revoke Millennium's Medicare billing privileges, an essential aspect of its business. Less than a month later, the U.S. Department of Justice ("DOJ") filed a complaint in the United States District Court for the District of Massachusetts against Millennium. The complaint was the result of a multi-year investigation (going back to at least 2012) and alleged Millennium violated several laws, including the False Claims Act.

Millennium reached a settlement in principle with the DOJ, CMS, and other government entities. However, Millennium did not have the liquidity to both pay the government settlement and service its debt obligations. After informing its lenders of its liquidity issues, an ad hoc group of lenders, including Voya, began negotiating a way for Millennium to restructure its obligations and pay the settlement. During the negotiations the lenders raised potential claims against MLH and TA relating to a lack of disclosure of the DOJ investigation.

After Millennium informed the government of the need to restructure its financial obligations in order to pay the settlement, the government set a deadline of October 2, 2015, for Millennium and its lenders to finalize a plan supported by both lenders and shareholders. This deadline was later extended to October 16, 2015.

Millennium, its shareholders, and the group of lenders (including Voya) engaged in intensive, "highly adversarial", "extremely complicated" and "arm's-length" negotiations in which all parties were represented by "sophisticated and experienced professionals."[4] On October 15, 2015, the eve of the government deadline, the parties reached an agreement. The agreement required MLH and TA to pay $325 million and for Millennium's shareholders to give up 100% of their equity to its lenders. In exchange MLH, TA and others received "full releases" and protective provisions (in case of a Chapter 11 reorganization).

Voya refused to approve the agreement and Millennium subsequently filed a Chapter 11 petition in November 2015.[5] Millennium sought bankruptcy court approval of a "prepackaged" plan of reorganization and Voya objected to confirmation of the plan.[6] Voya argued the releases were unlawful and the bankruptcy court lacked subject matter jurisdiction and the constitutional authority to approve them.

First, in consideration of the Supreme Court's ruling in *Stern v. Marshall*, the Bankruptcy Court explained that *Stern* is inapplicable when the proceeding at issue is plan confirmation. Further, the Bankruptcy Court stated that, even if *Stern* applied, the plan here complied with its limitations.[7]

The district court affirmed the bankruptcy court's ruling that *Stern* is inapplicable to plan confirmation proceedings. The district court then dismissed the remainder of Voya's objections as equitably moot because the releases were central to the plan, removing them would unravel the plan, and it would be inequitable to allow Voya to benefit from the restructuring while pursuing claims against MLH and TA.[8] Both the bankruptcy court and the district court found that Millennium could not have avoided

[4] *Id.* at 7.
[5] Chapter 11 Voluntary Petition, *In re Millennium Lab Holdings II, LLC,* 2017 BL 354864 (Bankr. D. Del. Oct. 3, 2017).
[6] The U.S. Trustee also objected to confirmation of the plan.
[7] *In re Millennium,* No. 18-3210, at 11.
[8] *Id.*

liquidation without the inclusion of the releases in the plan.[9] This appeal followed.

## The Opinion

The Court first considered Voya's argument that the bankruptcy court lacked constitutional authority to confirm a plan containing non-consensual third-party releases. The Court explained that, although the Supreme Court had rejected the authority of the bankruptcy court to rule on the claims at issue in *Stern*, matters arising in the claims reconciliation and allowance process could be adjudicated by a bankruptcy court.[10] Furthermore, the authority of the bankruptcy court was not limited to adjudicating matters arising from the claims reconciliation and allowance process but also applied to issues stemming from the bankruptcy itself.[11]

The Court articulated three takeaways from *Stern*. First, even while acting within its "core" statutory authority a bankruptcy court may violate Article III.[12] Second, however, a bankruptcy court satisfies Article III concerns when it resolves a matter "integral" to the restructuring.[13] Third, when determining whether a bankruptcy court has acted within its constitutional authority, courts should focus on the content of the proceeding to determine whether it would be necessarily resolved in the claims allowance process.[14]

Applying *Stern* to this case, the Court concluded that the bankruptcy court had constitutional authority to confirm the plan with the releases intact. The Court pointed out that the bankruptcy court, after careful analysis of the intense negotiations, determined that MLH and TA would not have been willing to make their contributions to the restructuring without the releases. Further, without the payment from MLH and TA – and the releases inducing them to contribute – Millennium would have ended up in liquidation. Therefore, the releases were "integral" to the restructuring and the bankruptcy court had authority to approve the plan.[15]

The Court acknowledged Voya's argument that allowing the bankruptcy court to approve the releases here could open the "floodgates" for approval of similar releases. The Court made clear, however, that its decision was not intended to expand bankruptcy court authority or allow creditors to game the system by demanding such releases. It explicitly stated that its precedents regarding third-party releases, which set forth exacting standards that must be satisfied for their approval, remain in effect. The Court said its ruling was "specific and limited" to "the particular facts of this case" where "the Bankruptcy Court's conclusion that the release provisions were integral to the restructuring was well-reasoned and well-supported by the record."[16]

The Court also concluded that the remainder of Voya's claims were equitably moot because, based on events since plan confirmation, any do-over of the plan would likely be impossible, and even if possible, would be disruptive to the plan and those that had relied upon it.[17] The Court emphasized again that its holding was limited, noting, "Nothing in our opinion should be read to imply that review of reorganization plans involving third-party releases will always or even often be barred as equitably moot and therefore effectively unreviewable. Again, our holding today is specific and limited to the particular facts of this case."[18]

## Implications of the Third Circuit's Decision

The Third Circuit made clear that, where a bankruptcy court concludes that releases are "integral" to the restructuring in a manner that is well-reasoned and

[9] *See In re Millennium*, No. 18-3210, at 8–9.
[10] *Id.* at 17–19.
[11] *See id.*, at 16–17 (citing *Stern*, 564 U.S. at 499) (emphasis added).
[12] *Id.* at 17.
[13] *Id.* at 17–19 (citing *Stern*, 564 U.S. at 497 (a particular "claim can be heard in bankruptcy when the . . . creditor has filed a claim, because *then* 'the ensuing preference action by the trustee become[s] integral to the restructuring of the debtor-creditor relationship.'")).
[14] *Id.* at 19.
[15] *Id.* at 20–23.
[16] *Id.* at 26.
[17] *Id.* at 27–35.
[18] *Id.* at 35, n.20.

well-supported by the record, non-consensual third party releases may be approved.

The Court's decision also noted some of the factors a court should consider when deciding the appropriateness of non-consensual releases. For example, in this case the Court took into account the information in the record regarding the length and intensity of the negotiations, their arms-length nature, the demand of MLH and TA for such releases in order to make their contribution to the plan, and the fact that without the contribution of MLH and TA, the end result would have been liquidation rather than reorganization. As noted previously, however, the Third Circuit took great care to limit its holding to the facts of this case, emphasizing that its holding was not intended to expand bankruptcy court authority to approve non-consensual releases.

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