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The Power of the Shield—Permanently Enjoining Litigation Against Entities other than the Debtor—a Look at In re *A. H. Robins Co.*

I. INTRODUCTION

Since its passage, the Bankruptcy Act of 1898 has impacted the relationship between a debtor and his creditors. Among the Act's primary purposes was to give an unfortunate debtor a "fresh start" on its return to economic stability. As the Supreme Court stated in *Wetmore v. Markoe*,[1] "systems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has been oppressive and to permit him to have a fresh start in business or commercial life, freed from the obligation and responsibilities which may have resulted from business misfortunes."[2] Another purpose of bankruptcy laws is to "provide a set of equitable rules for the division of the debtor's property among various creditors."[3]

One rule among this set is section 362(a) of the Bankruptcy Code,[4] which provides that the filing of bankruptcy immediately acts to enjoin all creditors from taking steps to recover on claims against the debtor. Known as the "automatic stay provision," this stay affects most claims against the debtor[5] and prevents an otherwise swift plundering of the debtor by alert creditors who might prematurely cause the dissolution of an otherwise salvageable debtor. While at first glance the automatic stay appears to benefit only the debtor, it was also intended to protect the interests of creditors by preventing those with notice of the debtor's financial distress from recovering the debtor's assets at the expense of creditors with similar priority rights who might be less aware of the debtor's precarious financial condition.[6] Bank-

1. 196 U.S. 68 (1904).

2. *Id.* at 77.

3. J. WHITE, BANKRUPTCY AND CREDITORS' RIGHTS 29 (1985).

4. The Bankruptcy Act of 1898 was revised in 1978 as the Bankruptcy Reform Act of 1978 now codified in 11 U.S.C. §§ 101-1330 (1982) and more commonly known as the "Bankruptcy Code" or the "Code."

5. *See* 11 U.S.C. § 362 (1982).

6. *See* Ishii-Chang, *Litigation and Bankruptcy: The Dilemma of the Codefendant*

ruptcy under Chapter 11 of the Code[7] provides for the reorganization of the debtor's business affairs. During a Chapter 11 reorganization, the automatic stay is in effect until a plan of reorganization is confirmed by the Bankruptcy Court. After confirmation, the rights of creditors *vis a vis* the debtor are governed by the provisions of the confirmed plan and, except as provided in the plan, the debtor's original obligations are normally discharged.[8] Recently, however, a question has surfaced regarding the effect that confirmation of a reorganization plan has on an entity not technically in Chapter 11 bankruptcy but which has a close relationship to the debtor. In some cases the protection given to such entities affects the outcome and feasibility of the reorganization plan.

Such a scenario recently surfaced in In re *A. H. Robins Co.*,[9] where the Fourth Circuit Court of Appeals, under its section 105(a) equitable powers, upheld a provision of the *Robins* reorganization plan that enjoined creditors and tort claimants from pursuing suits against Robins' guarantors and affiliates. Section 105(a) provides: "The Court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[10] Opponents of the *Robins* decision have complained that the Fourth Circuit, in affirming the injunction provision, overstepped express terms contained in section 524(e) of the Bankruptcy Code. Except with regards to spousal debts, section 524(e) provides: "[D]ischarge of a debt of the debtor

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Stay, 63 AM. BANKR. L.J. 257 (1989).

7. 11 U.S.C. §§ 1101-1174 (1982).

8. 11 U.S.C. §§ 523 and 727 (1982) specify conditions under which debts may not be dischargeable in bankruptcy.

9. 880 F.2d 694 (4th Cir.), *cert. denied*, 110 S. Ct. 331 (1989). A. H. Robins has been sued extensively in connection with its Dalkon Shield product, an intrauterine device used for contraception which was shown to cause permanent infertility and even death in a number of women. Other district court and Fourth Circuit decisions involving A. H. Robins Co., Inc. are as follows: *In re* A. H. Robins Co., 880 F.2d 769 (4th Cir. 1989); *In re* A. H. Robins Co., 880 F.2d 709 (4th Cir. 1989)(Breland settlement); *In re* A. H. Robins Co., 862 F.2d 1092 (4th Cir. 1988); *In re* A. H. Robins Co., 846 F.2d 267 (4th Cir. 1988); Maressa v. A. H. Robins Co., 839 F.2d 220 (4th Cir. 1988), *cert. denied*, 109 S. Ct. 76 (1989); Grady v. A. H. Robins Co., 839 F.2d 198 (4th Cir.), *cert. dismissed*, 109 S. Ct. 201 (1988); Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299 (4th Cir. 1987), *cert. denied*, 485 U.S. 962 (1988); Beard v. A. H. Robins Co., 828 F.2d 1029 (4th Cir. 1987), *cert. denied*, 108 S. Ct. 1246 (1988); Committee of Dalkon Shield Claimants v. A. H. Robins Co., 828 F.2d 239 (4th Cir. 1987); Van Arsdale v. Clemo, 825 F.2d 794 (4th Cir. 1987); Vancouver Women's Health Soc. v. A. H. Robins Co., 820 F.2d 1359 (4th Cir. 1987); and A. H. Robins Co., v. Piccinin, 788 F.2d 994 (4th Cir.), *cert. denied*, 479 U.S. 876 (1986).

10. 11 U.S.C. § 105(a) (1982).

does not affect the liability of any other entity on, or the property of any other entity for, such debt."[11] Proponents of the *Robins* decision have disagreed, claiming the *Robins* decision was not inconsistent with section 524(e) and that justice was better served by the decision and its invocation of the equitable override, section 105(a).

This note will examine how section 524(e) of the Bankruptcy Code, which limits the bankruptcy court's powers to permanently enjoin suits against parties outside of bankruptcy, should relate to the unique facts in *Robins* and whether the Fourth Circuit properly exercised its discretion in using its section 105(a) equitable powers to affirm the injunction. This note begins by discussing section 105(a) and a line of cases that support temporary injunctions under its auspices. Then, section 524(e), an apparent obstacle to the use of section 105(a) for granting permanent injunctions, is introduced and discussed. Following the discussion of the above Code provisions, the note briefly sets forth the unique facts of *Robins* and the rationale of the Fourth Circuit as a backdrop for an analysis of the injunction issue. Finally, the facts of *Robins* are analyzed against sections 105(a), 524(e) and 1123(b)(5), together with court decisions interpreting these Code provisions. This note concludes with a new test that justifies the Fourth Circuit's permanent injunction in the *Robins* case because (1) the *Robins* reorganization plan provided for full payment of claims by its unsecured creditors as found by the district court, (2) the success of the reorganization depended upon confirmation of the plan of which the injunction was an essential element, and (3) the overwhelming majority of creditors voted for the reorganization plan that contained the injunction.

II. BACKGROUND

A. *Section 105(a)*

The basis for the bankruptcy court's equitable powers was originally found in 28 U.S.C. section 1481, later superceded by the 1984 amendments to the Bankruptcy Reform Act of 1978.[12] The bankruptcy court, however, has traditionally been vested with the authority to issue injunctive relief.[13] In *NLRB v.*

11. 11 U.S.C. § 524(e) (1982).
12. *See* 2 COLLIER ON BANKRUPTCY ¶ 105.02 (1988).
13. *See, e.g., Ex parte* Baldwin, 291 U.S. 610 (1934).

Bildisco & Bildisco,[14] the Supreme Court stated: "The Bankruptcy Court is a court of equity, and in making [its] determination it is in a very real sense balancing the equities . . . . [T]he Bankruptcy Court must focus on the ultimate goal of Chapter 11 when considering . . . equities."[15] Section 105(a) preserves this traditional equitable power of the Bankruptcy Court.

B. Temporary Injunctions

One of the recent and increasingly common uses of section 105(a) involves cases that attempt to temporarily restrain court proceedings against nondebtor entities when such proceedings might have an impact on the principal bankruptcy case.[16] In In re *Arrow Huss, Inc.*,[17] a Chapter 11 debtor filed a motion to protect its present officers and employees against claims that could be asserted by creditors against them individually. The rationale set forth by the debtor to support the injunction was that litigation against individuals would severely harm the reorganization effort. The court held that the "power to temporarily enjoin litigation against nondebtor principals of a corporate Chapter 11 debtor during the pendency of the reorganization case is a valid and useful exercise of Section 105."[18] The court added, however, that only because the injunction was essential to the formulation and execution of a plan was its use justified. The rationale set forth in *Arrow Huss* reflects the reasoning of other jurisdictions addressing the issue of the temporary injunction.[19] Similarly, in In re *Family Health Services, Inc.*,[20] the court permitted a temporary injunction that enjoined creditors from directly billing officers and guarantors because such a practice severely interfered

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14. 465 U.S. 513, 527 (1984).

15. *Id.*

16. A temporary injunction should be distinguished from a permanent injunction. A temporary injunction lasts for a specific and identifiable period of time or will at some future date be reconsidered by the court. A permanent injunction will not expire by its terms and will not be reconsidered by the court in the normal course of events.

17. 51 Bankr. 853 (Bankr. D. Utah 1985).

18. *Id.* at 859.

19. *See, e.g., In re* Equity Funding Corp., 396 F. Supp. 1266 (C.D. Cal. 1975)(enjoining actions against the debtor's wholly-owned subsidiaries, which would frustrate the ability of the court to reorganize or execute a plan). *See also In re* Otero Mills, Inc., 21 Bankr. 777 (Bankr. D.N.M. 1982); *In re* Original Wild West Foods, Inc., 45 Bankr. 202 (Bankr. W.D. Tex. 1984). The temporary injunction issue is also discussed *infra* at notes 82-83 and in the accompanying text.

20. 105 Bankr. 937 (Bankr. C.D. Cal. 1989).

with the debtor's ongoing business operations and seriously impaired its ability to reorganize.[21]

As evidenced by these two cases, courts that sanction the use of section 105(a) to temporarily enjoin litigation against third-party nondebtors limit its use to instances when the injunction is essential to a successful reorganization, and then only under unusual circumstances according to the discretion of the court.

C. Section 524(e)

The principal objection espoused by opponents of permanent injunctions for nondebtor entities is section 524(e). This section states that the liability of an entity other than the debtor is not affected by the debtor's discharge in bankruptcy.[22] Because a complete discharge of nondebtors is not an issue in temporary injunction motions, this obstacle is not faced by movants for temporary nondebtor injunctions. While at first blush section 524(e) appears to prohibit a permanent injunction against a nondebtor entity in bankruptcy, a careful reading of the section reveals only that a *discharge of the debtor* has no *automatic* effect on third parties. In other words, section 524(e) does not expressly prohibit a court, in its discretion and apart from the automatic discharge of the principal debtor, from limiting the liability of a third-party debtor.[23]

In *Republic Supply Co. v. Shoaf*,[24] the Fifth Circuit acknowledged the difference between a "bankruptcy court's order discharging or altering the underlying debt . . . not operat[ing] to release the guarantor" and "the effect of a bankruptcy court's final and unappealed order of confirmation that by its express terms releases a guarantor."[25] The rationale behind this inter-

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21. *Id.* at 946.

22. *See supra* text accompanying note 11.

23. Some courts have held that § 524(e) prohibits any attempt by a court or a debtor to affect the liability of a guarantor or third-party debtor after the confirmation of a plan of reorganization. *See, e.g.*, United States v. Stribling Flying Serv., Inc., 734 F.2d 221 (5th Cir. 1984); RIDC Indus. Dev. Fund v. Snyder, 539 F.2d 487 (5th Cir. 1976), *cert denied*, 429 U.S. 1095 (1977) (*Snyder* was a ruling under § 16 of the Act of 1898). On its face, however, § 524 does not expressly prohibit a consensual plan from enjoining suits against third-party debtors. It simply states that the discharge of the debtor alone does not discharge third-parties. *See* Republic Supply Co. v. Shoaf, 815 F.2d 1046 (5th Cir. 1987). Thus, it is conceivable that a plan could provide for the release of a third party and be effective.

24. 815 F.2d at 1050-51.

25. *Id.* at 1051.

pretation of section 524(e) becomes clearer upon reference to its origin. The predecessor to section 524(e) was section 16 of the Act of 1898,[26] which stated: "The liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt *shall not* be altered by the *discharge* of such bankrupt."[27] The purpose of section 16 was to clarify that a creditor, by simply voting for a bankruptcy plan that discharges a debtor, does not inadvertently by the same act discharge third-party creditors or guarantors.[28] Thus, even in drafting section 16, Congress did not intend to automatically prohibit a court from limiting nondebtor liability as long it did so independent of the debtor's discharge. Since section 524(e) replaces the words "shall not" with "does not" and deleted specific reference to guarantors, sureties or co-debtors, it is even less restrictive than section 16. The purpose behind section 16, together with the amendments thereto as contained in section 524(e), gives credence to the distinction drawn in *Shoaf* and the *Shoaf* court's interpretation of section 524(e).

III. *In re A. H. Robins Co.*

A. Facts

In 1970, A. H. Robins Company, Inc., (hereinafter "Robins") acquired the rights to the Dalkon Shield,[29] which it distributed internationally from 1970 to 1975. By mid-1985, there were nearly 6,000 lawsuits and claims arising from the Dalkon Shield pending against Robins and, in many cases, against others with indemnification and contribution rights against Robins. Most of the claims involved injuries resulting from infections to the pelvic area that caused severe inflammation and, in many cases, sterility. On August 21, 1985, faced with the financial drain caused by soaring litigation costs and the inability to defend hundreds of suits at the same time, Robins sought refuge under Chapter 11 of the Bankruptcy Code.

After several years of litigation and negotiation, and following a multi-million dollar, eighteen-month analysis of Dalkon

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26. 11 U.S.C. § 16 (repealed 1978). The current § 524(e) is an amended version of § 16 of the Bankruptcy Act of 1898.

27. *Id.* (emphasis added).

28. *See* W. COLLIER, COLLIER ON BANKRUPTCY ¶ 16.02 at 1523-27 (14th rev. ed. 1978).

29. The Dalkon Shield is an intrauterine birth control device which was typically inserted by a physician.

Shield claims, the court held six days of hearings during which it heard medical, statistical, epidemiological, and other expert testimony. On December 11, 1987, the court announced that the total amount of money necessary to pay all Dalkon Shield claims and related administrative expenses was $2.475 billion, payable over a reasonable period of time. Following the announcement of this "estimate" of the amount of total claims, several entities submitted proposals for the acquisition of Robins. Robins' board of directors selected the acquisition proposal of American Home Products Corporation ("AHP"). AHP's proposal was premised on (1) payment of Dalkon Shield claims in full and (2) freeing AHP, Robins, and their affiliates and respective personnel from residual liabilities and litigation connected with the Dalkon Shield. In conjunction with the proposal, Robins and the numerous parties in interest finally succeeded in negotiating a comprehensive and consensual plan of reorganization resolving the mass tort litigation. The plan depended upon AHP's acquisition of Robins.[30]

The cornerstone of the *Robins* plan was the non-reversionary payment by AHP and Robins of $2.3 billion in cash into a claimant's trust fund upon the consummation of the plan, a sum the district court found exceeded its estimate of the total tort claims arising from the use of the Dalkon Shield. However, in order for AHP to agree to the purchase of Robins, AHP insisted on a provision in the plan that would channel all claims against Robins to the claimant's trust fund. Thus, all claims would be directed away from AHP and Robins to the claimants' trust for evaluation and payment to provide for fair treatment of claims and to protect AHP and Robins from piecemeal litigation over the Dalkon Shield. The plan was overwhelmingly approved by all classes of creditors, including in excess of ninety-four percent of the Dalkon Shield claimants who voted on it.

On July 25, 1988, the court issued an order confirming the

30. There was testimony presented at the plan confirmation hearing that it was vital to AHP's acquisition of Robins that it be protected from the claims related to the Dalkon Shield and from any involvement in litigation regarding the Dalkon Shield. *In re* A.H. Robins Co., 88 Bankr. 742, 748 (Bankr. E.D. Va. 1988). Indeed, consistent with the above position, sections 7.02(a)(vii), (ix) and (xv) of the plan made it a condition to consummation of the plan that the order confirming the plan (i) contain the injunctive provisions set forth in the plan, (ii) reflect that those provisions "are an integral part of the compromises and settlements incorporated in the Plan," and (iii) provide that "the provisions of the Confirmation Order shall be non-severable and mutually dependent."

plan and an opinion in support thereof.[31] The opinion set forth the process by which the court arrived at the estimated amount of tort claims and ruled that the payment amount proposed by the plan would satisfy all outstanding tort claims. The opinion also discussed the plan's injunctive provisions and found that because of the unusual circumstances surrounding the case, the court had power to approve the injunction pursuant to section 105 of the Bankruptcy Code.[32] The court further held that the injunction was necessary to effectuate the purchase of Robins by AHP—the end result being to better provide funds for the tort claimants. Moreover, the court found that the provisions of the plan gave tort claimants equal access to the funds and guaranteed fair treatment to all Dalkon Shield claimants.[33]

B. Reasoning of the Fourth Circuit

In its affirmance of the lower court's approval of the plan, the Fourth Circuit addressed several issues in addition to the injunction issue: (1) the lower court's finding of adequate information in the disclosure statement,[34] (2) the court's adoption of

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31. *Robins*, 88 Bankr. at 742.

32. *See* 11 U.S.C. § 105 (1982).

33. The district court found that:

> this Court [has] jurisdiction to enjoin proceedings in other courts, enjoin parties from commencing or continuing litigation, and to otherwise approve the channelling provisions in order to ensure: (i) the efficient administration of Robins' estate; (ii) the efficient administration of the [t]rusts; (iii) the systematic evaluation and payment of Dalkon Shield claims in an orderly, fair manner, applying the same rules to all; (iv) that the bulk of the funds in both [t]rusts are made available for the payment of Dalkon Shield personal injury claims pursuant to the same method of claims evaluation; (v) minimization of expenditures and transaction costs payable from the Other Claimants Trust, for protracted litigation of questionable value against third parties; (vi) successful consummation of the Plan; (vii) that Dalkon Shield personal injury claimants do not bypass the Claims Resolution Facility, to the detriment of other Dalkon Shield personal injury claimants; (viii) equality of distribution to Dalkon Shield personal injury claimants; and (ix) rehabilitation and reorganization of Robins, free from direct and indirect involvement in further Dalkon Shield litigation.

Robins, 88 Bankr. at 742.

34. 11 U.S.C. § 1125(b) (1982) requires that before a plan of reorganization may be submitted for voting, it must be found to contain "adequate information" and be approved by the court. "Adequate information" is defined in the Code as:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan.

a "one claimant one vote" procedure,[35] and (3) the court's finding that the plan was feasible.[36] The Fourth Circuit ultimately focused, however, solely on the injunction issue.[37]

The *Robins* plan expressly prohibits claimants from "suing all third parties other than 'insurer[s]' " and "claims based exclusively on medical malpractice."[38] In considering and upholding the injunction, the lower court stated: "[T]he injunction is a proper exercise of the district court's power to channel claims to a specific *res* or alternately . . . the injunction is proper because 94.38% of the claimants voted for the Plan and thereby consented to the injunction."[39] Although the Fourth Circuit Court of Appeals' reasoning for supporting the *Robins* injunction differed somewhat from that of the lower court, it reached the same result.

In its analysis of the permanent injunction issue, the Fourth Circuit initially recognized that the only parties affected by the injunction were a minority of potential claimants—"[c]lass B members who ha[d] elected to opt-out of the *Breland* settlement."[40] The Court of Appeals justified its treatment of these

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11 U.S.C. § 1125(a)(1) (1982).

35. The challenge to the voting procedure arose out of 11 U.S.C. § 1126(c) (1982), which requires that each class of creditors (in this case the class of Dalkon Shield claimants) that approves the plan must do so with at least "two-thirds in [dollar] amount and more than one-half in number [of claimants]." *Id.* The argument of appellants was that although the majority of claimants in number approved the plan, the majority may not have represented the necessary two-thirds dollar amount in claims. *Id.*

36. Appellants attacked the plan by citing 11 U.S.C. § 1129(a)(7)(A)(ii) (1982), which requires that an impaired class of claims must "receive . . . under the plan . . . property of a value . . . that is not less than the amount that . . . [they would] receive . . . if the debtor were liquidated under Chapter 7." (An impaired class is by definition a class of persons who will be treated differently by the plan than they would have been treated in the absence of the bankruptcy filing). Appellants also cited 1129(a)(11), the feasibility section which requires that confirmation is not likely to be followed by liquidation or the need for further reorganization. *In re* A.H. Robins Co., 880 F.2d 694, 698 (4th Cir.), *cert. denied*, 110 S. Ct. 376 (1989).

37. Since this note involves only the injunction issue, the three other issues will not be analyzed here.

38. *Robins*, 880 F.2d at 701. Thus, the only third parties affected by the injunction are "Robins' directors, Robins' and Aetna's attorneys, and Aetna. These parties may be liale as joint tortfeasors with Robins for Dalkon Shield injuries. *Id.* at 700.

39. 880 F.2d at 700.

40. The Breland settlement is set forth and explained in *Robins*, 880 F.2d at 700 and provides for a mandatory non-opt-out class:

> for members of class A and a class which allows an opt-out for compensatory damages for members of class B. Class A is defined as those Dalkon Shield claimants who met the filing deadlines of the district court and therefore have a non-subordinated claim against the trust fund set up for the claimants in the

parties by asserting that the Breland settlement provided that all class B claimants would be paid from certain insurance policies provided by Aetna. The court assumed that since no class B members had challenged the adequacy of those insurance funds, the "claims of all class B claimants who wish to have the merits and amount of their claims ascertained . . . [would] be fully satisfied."[41] All other claimants were classified into class A and non-opt-out class B members who had accepted the Breland settlement and were thereby estopped from suing the directors and attorneys for Robins and Aetna. Thus, after concluding that the only entities affected by the injunction would have their claims fully paid by insurance funds and finding that any suit by such entity "would affect the bankruptcy reorganization in one way or another," the Fourth Circuit proceeded with its analysis under section 105(a).

The Fourth Circuit began its analysis by emphasizing first and foremost that "bankruptcy courts are courts of equity."[42] While quoting the Second Circuit, the *Robins* court stated: "Particularly since the insurance settlement/injunction arrangement was essential in this case to a workable reorganization, it falls within the bankruptcy court's equitable powers 'which traditionally have been invoked to the end that . . . substance will not give way to form, that technical considerations will not prevent substantial justice.' "[43] After equity considerations, the court dealt with how, under the proposed plan, all affected class members could have their claims fully satisfied by staying within

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> Robins' reorganization. Class B is defined as those Dalkon Shield claimants who did not meet the filing deadline or like procedural requirements and are therefore not eligible for a non-subordinated recovery from the trust fund for reasons not related to the abstract merits of the claims.

Id.

41. 880 F.2d at 701. The major procedural difference between class A and class B claimants was that class A claimants would be entitled to a jury trial and would be paid from the trust fund, while class B members would have claims determined by a claims resolution facility and would be paid from outlier policies issued by Aetna. *Id.* All opt-out class B claimants (those who opted out of the Breland settlement) could only opt-out to claim compensatory, not exemplary damages. Because of this limitation, it is argued that there were sufficient funds under the plan to satisfy all claims against the estate.

42. 880 F.2d at 701 (citing NLRB v. Bildisco & Bildisco, 465 U.S. 513, 527 (1984); *In re* Old Orchard Inv. Co., 31 Bankr. 599 (W.D. Mich. 1983); 11 U.S.C. § 105(a) (1982)). *See supra* text accompanying notes 13-15.

43. *Id.* at 702 (quoting MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 94 (2d Cir.), *cert. denied*, 109 S.Ct. 176 (1988), quoting *In re* U.N.R. Indus. Inc., 725 F.2d 1111, 1119 (7th Cir. 1984)).

the settlement.[44] In its analysis, the court justified its right to select and direct claimants to an exclusive source for claim satisfaction by comparing its actions to the doctrine of marshalling of assets under which the court has power to "order a creditor who has two funds to satisfy his debt, to resort to the fund that will not injure or defeat other creditors."[45]

The Fourth Circuit addressed the section 524(e) argument by recognizing that some courts have indeed held that section 524(e) "results in the bankruptcy court having no power to discharge liabilities of a non-debtor pursuant to the consent of creditors as a part of a reorganization plan."[46] In rejecting that interpretation of section 524(e), the Fourth Circuit espoused the Fifth Circuit's ruling in *Shoaf*: "Although section 524 has generally been interpreted to preclude release of guarantors by a bankruptcy court, the statute does not by its specific words preclude the discharge of a guaranty when it has been accepted and confirmed as an integral part of a plan of reorganization."[47] The *Robins* court thus held that, at least in light of the peculiar facts in *Robins*, the injunction fell within the Bankruptcy Court's equity powers as provided in section 105(a).

The heart of the Fourth Circuit's analysis, however, was its focus on the ultimate success of the plan and its fear of the effect that failure to confirm the plan would have on the tort claimants and other creditors. The court stated:

> It is essential to the reorganization that these opt-out plaintiffs either resort to the source of funds provided for them in the Plan and *Breland* settlement or not be permitted to interfere with the reorganization and thus with all the other creditors . . . . Permitting a suit by them in violation of the Plan is a defeat of the Plan and a resulting defeat of the other creditors.[48]

Although the court's statutory analysis was all-important to resolution of the injunction issue, its concern over the ultimate treatment of the tort claimants was the pillar upon which the court finally rested.

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44. 880 F.2d at 701.

45. *Id.* (citing Columbia Bank for Cooperatives v. Lee, 368 F.2d 934, 939 (4th Cir. 1966), *cert. denied*, 386 U.S. 992 (1967)).

46. 880 F.2d at 702. *See* Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985); Union Carbide Corp. v. Newboles, 686 F.2d 593 (7th Cir. 1982).

47. Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1050 (5th Cir. 1987).

48. *Id.* at 701-02.

IV. ANALYSIS

A. Critique of the Fourth Circuit

As discussed earlier, the issue addressed by *Robins* is whether a district court's confirmation of a reorganization plan, which included a provision enjoining personal injury creditors from pursuing their claims against third parties, must be overturned pursuant to bankruptcy code section 524(e) when (1) the plan provided for a $2.3 billion trust fund for payment of claims, (2) the purpose of the injunction was to channel all such claims to the trust for payment of claims, (3) the district court determined after extensive expert testimony, investigation and analysis that the trust amount was sufficient to pay all such claims in full, (4) the funds placed in the trust would not be available without the injunction, and (5) the creditors overwhelmingly voted to accept the plan.[49] The following is an attempt to analyze the end result and the rationale taken by the Fourth Circuit in ruling to uphold the *Robins* injunction. The analysis concludes with a suggested test that is intended to help courts determine when a *Robins*-type injunction may be appropriately confirmed as a part of a reorganization plan.

If the ultimate purpose of the Bankruptcy Code is to find and impart justice, there is little question that the Fourth Circuit reached the proper result in its adjudication of the *Robins* injunction issue: without the plan, fewer assets would have been available to the claimants and Robin's viable operations would not have been allowed to continue. The directive of bankruptcy courts, to emphasize justice and equity, was well recognized by the *Robins* court in its reference to and reliance on section 105(e) in the context of *Robins'* unique facts. It is this emphasis on the end result that is crucial to accurate interpretation of the Bankruptcy Code.

The Supreme Court recently recognized this "end result" orientation in Bankruptcy Code analysis in *United Savings Association of Texas v. Timbers of Inwood Forest Associates*.[50] In *Timbers* the Supreme Court held that it was incomprehensible that Congress would draft provisions of the Bankruptcy Code with the intent to push bankruptcy estates into liquidation.[51]

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49. *See* Brief for the Respondent at (i), *In re* A. H. Robins Co., 880 F.2d 964 (4th Cir. 1989) (No. 89-441).

50. 484 U.S. 365, 374 (1988).

51. *Id.* The opinion states:

Similarly, under the facts of *Robins*, if the Fourth Circuit had failed to uphold the permanent injunction, this might well have resulted in the eventual liquidation of Robins' assets in a probable failing attempt to satisfy the tort claimants.

In In re *Johns-Manville Corp.*,[52] the Second Circuit, in addressing a temporary injunction issue and holding that the injunction was permissible, stated:

> [I]n our view, if the bankruptcy court may ever use its equitable powers under section 105(a) to enjoin actions pursued in other courts . . . it may exercise that power where there is a basis for concluding that rehabilitation, *the very purpose for the bankruptcy proceedings*, might be undone by the other action . . . . This provision [section 105] has been construed liberally to enjoin suits that might impede the reorganization process.[53]

Such was the case in *Robins*.

Courts prior to and since *Robins* have taken a close look at the equities surrounding injunctions that affect third parties. For example, in *Republic Supply Co. v. Shoaf*[54] the Fifth Circuit, as set forth above, held that specific words contained in a reorganization plan that released a guarantor from liability were valid to enjoin creditors from bringing suit against the guarantor when the injunction had been accepted and confirmed as an integral part of a plan.[55] Other courts have dismissed a *Robins*-type injunction, although such courts have addressed facts

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> We think it unlikely that § 506(b) [dealing with allowable interest on secured claims] codified the pre-Code rule with the intent, not of achieving the principal purpose and function of that rule, but of providing over-secured creditors an alternative method of compensation. Moreover, it is incomprehensible why Congress would want to favor under-secured creditors with interest if they move for it under § 362(d)(1) at the inception of the reorganization process—thereby probably pushing the estate into liquidation—but not if they forbear and seek it only at the completion of the reorganization.

Id. at 373-74.

52. 801 F.2d 60 (2d Cir. 1986).

53. *Id.* at 64-65 (emphasis added).

54. Republic Supply Co. v. Shoaf, 815 F.2d 1046 (5th Cir. 1987).

55. *Id.* at 1050. In *Shoaf*, the bankruptcy court confirmed a reorganization plan that released a guaranty when there was no objection to the provision upon confirmation. Nor was the confirmation order appealed. *Shoaf* originated from a separate suit brought by a creditor against the released guarantor. The guarantor pled that the court was without jurisdictional grounds to decide the case on the grounds of *res judicata* and the district court held for the creditor. On appeal, the Fifth Circuit reversed the district court and distinguished the facts of *Shoaf* from prior decisions interpreting § 524(e). *See id.* at 1050-51 and *supra* text accompanying note 48.

clearly distinguishable from those set forth in *Robins*. For example, in In re *American Hardwoods, Inc.*[56] the Ninth Circuit, although dismissing a plan containing a injunction similar to that in *Robins*, distinguished *American Hardwoods* from *Robins* based on a lack of compelling facts as found in *Robins*.[57] Today, the Fifth,[58] Ninth[59] and Second[60] Circuits, along with the Fourth, have distinguished between the unacceptable discharge of guarantors pursuant to a discharge of a principal debtor and an acceptable discharge pursuant to provisions in a reorganization plan due to their lack of conflict with section 524(e). Such willingness by these courts to distinguish critical facts and to apply the Code suggests the maturation of Bankruptcy as an equitable remedy.

B. Strengthening the Fourth Circuit's Analysis

While the end result in *Robins* appears correct, its analysis could be clarified and strengthened. Several recent Supreme Court decisions have specifically addressed the issue of Bankruptcy Code interpretation, and at least one Bankruptcy Code provision not cited by the Fourth Circuit lends concrete support to the *Robins* position.

1. Section 524(e) and code interpretation case law

One clue into the literal meaning of section 524(e) is the consideration of guidelines recently propounded by the Supreme Court for interpretation of the Bankruptcy Code. In *United States v. Ron Pair Enterprises, Inc.*[61] the United States Supreme Court stated:

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56. 885 F.2d 621 (9th Cir. 1989).

57. The Ninth Circuit distinguished the facts in *American Hardwoods* from *Robins* by stating that:

> American's bankruptcy proceeding presents no such unusual facts. Its reorganization did not contemplate the balancing of some 195,000 tort claimants alleging injuries totaling approximately $2.457 billion; the permanent injunction sought by American was not overwhelmingly approved by creditors; the injunctions would affect American's most significant creditor, not merely 1.5% of its creditors; and American does not argue, nor did the court find, that the permanent injunction is "essential to the plan" or that the entire reorganization "hinged" on it.

Id. at 627 (citations omitted).

58. *See* Republic Supply Co. v. Shoaf, 815 F.2d 1046 (5th Cir. 1987).

59. *See In re* American Hardwoods, Inc., 885 F.2d 621 (9th Cir 1989).

60. *In re* Johns-Manville Corp., 801 F.2d 60, 63-64 (2d Cir. 1986).

61. 109 S. Ct. 1026 (1989). In *Pair* the Supreme Court was addressing section 506(b)

> The task of resolving the dispute over the meaning of [the applicable bankruptcy section] begins where all such inquiries must begin: with the language of the statute itself . . . . The plain meaning of legislation should be conclusive, except in the "rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters . . . . In such cases, the intention of the drafters, rather than the strict language, controls."[62]

This statement, which precedes the *Pair* Court's analysis of the issues before it, suggests that proper interpretation of the Bankruptcy Code requires attention to the Code language itself and the final result.

In another recent case, the Supreme Court proposes a third element for proper Bankruptcy Code analysis—that Bankruptcy Code provisions can be misinterpreted if read in isolation. In *United Savings Assn. of Texas v. Timbers of Inwood Forest Associates, Ltd.*,[63] the court stated: "Statutory construction . . . is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme . . . because only one of the permissible meanings produces a substantive effect *that is compatible with the rest of the law.*"[64]

From the above federal caselaw, it can be concluded that the first hurdle in interpreting section 524(e) is to determine whether the section expressly prohibits a *Robins*-type injunction. This should be a mandatory first step, and it should be attempted with the end result in mind in the context of bankruptcy principles as a whole. If section 524(e) does not provide an express basis for denying confirmation of the injunction, and no other express provision is contained in the Code, there is no ground for precluding the injunction. In the context of the *Rob-*

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of the Bankruptcy Code, which involves the payment of interest on an over-secured claim. While the section is not the same, the principle of the decision should be applicable in the present case.

62. *Id.* at 1030-31 (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982) (citations omitted)). The *Pair* statement suggests that when a strict interpretation of a statute cuts against the general scheme of legislation, such legislation should not necessarily be interpreted strictly but, rather, it should be interpreted towards imparting justice and equity. Assuming that § 524(e) prohibits any limitation of the liability of third parties, the claim that § 524(e) precludes a reorganization plan from limiting the liability of third parties under any circumstances appears to produce a result demonstrably at odds with the intention of its drafters if the purpose of the Bankruptcy Code is to impart justice and equity.

63. 484 U.S. 365, 371 (1988).

64. *Id.* (emphasis added) (citations omitted).

ins case, it is evident that the *Robins* injunction provisions are not at odds with section 524(e). Moreover, pursuant to the above Supreme Court cases, even if section 524(e) expressly prohibited a permanent injunction, that provision could be interpreted in light of the surrounding facts if a strict interpretation of the section would "produce a result demonstrably at odds with the intention of its drafters" or one "not compatible with the rest of the law."[65] The Fourth Circuit's *Robins* analysis could have been significantly strengthened by reference to and analysis of the above Supreme Court decisions.

2. Decisions based on distinguishable facts as further support

While as yet few courts have addressed the *Robins* permanent injunction issue, no such court has held that section 524, under facts substantially similar to those found in *Robins*, prohibits confirmation and implementation of a reorganization plan containing a permanent injunction of creditor actions against non-debtor entities. For example, in *Union Carbide Corp. v. Newboles*,[66] while the Seventh Circuit stated that a provision contained in a reorganization plan could not act to discharge guarantors from liability to creditors upon confirmation of the plan, the facts and law before the *Union Carbide* court were strikingly dissimilar to the facts in *Robins*.

First, *Union Carbide* was decided pursuant to section 16 of the Bankruptcy Act, which was more restrictive than its replacement, section 524.[67] Second, in *Union Carbide*, the proposed reorganization plan provided for only a fifty percent payment to unsecured creditors, in marked contrast to *Robins'* attempt to provide for payment of all unsecured claims.[68] While the above facts and law distinguish the *Union Carbide* rationale from that set forth in *Robins*, the shining gem of the Seventh Circuit's *Union Carbide* analysis is its recognition of the specific language of section 16 and section 16's specific reference to guarantors.

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65. 109 S. Ct. at 1030-31 (quoting *Griffin*, 458 U.S. at 571).

66. 686 F.2d 593 (1982).

67. *See supra* text accompanying notes 26-28.

68. *See also* Underhill v. Royal, 769 F.2d 1426 (9th Cir. 1985), a Ninth Circuit case which states a position contrary to the *Robins* interpretation. *Underhill* can be distinguished from *Robins* in that the *Underhill* creditors were to receive only a 20% satisfaction of their claims, and the release was not included in the plan of reorganization. *Id.* at 1430. That *Underhill* is distinguishable from *Robins* is clarified in the *American Hardwoods* decision decided later by the Ninth Circuit. *See In re* American Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989).

Section 16 stated: "[T]he liability of a person who is a co-debtor with, or *guarantor* or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt."[69] In marked contrast, the Bankruptcy Code amendments to section 16, presently known as section 524(e), deleted any reference to guarantors, sureties or co-debtors.[70] Thus, today's courts should interpret section 16's successor according to its express terms and not retain the taint and persuasion of the former law.

3. Statutory support: section 1123(b)(5)

Given the Fourth Circuit's decision that section 524(e) does not expressly prohibit the *Robins* injunction and, in light of the Supreme Court's admonition that bankruptcy courts first look at the entire statutory context for interpretory guidance[71] and analyze cases in light of "policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code,"[72] the *Robins* court should have looked to section 1123(b)(5) of the Bankruptcy Code for direction in and justification of its holding.[73] Section 1123(b)(5) states: "[A] plan may include any other appropriate provision not inconsistent with the applicable provisions of this title."[74] Section 1123, by its terms, sanctions a provision like the *Robins* injunction if the provision is not contrary to express provisions of the Code and is appropriate.[75] By including the "appropriate, not inconsistent" language, section 1123(b)(5) supplies the grounds for an approach to approving a permanent *Robins*-type injunction provision that is not only compatible with both Sections 524(e) and 105(a), but also promotes the purposes of the Bankruptcy Code. This "appropriate, not inconsistent" test also has the benefit of maintaining the narrow application standard

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69. 11 U.S.C. § 34 (repealed effective October 1, 1979).

70. *See supra* text accompanying note 11.

71. "Statutory construction . . . is a holistic endeavor." United Savings Assn. v. Timbers of Inwood Forest Associates, 484 U.S. 365, 365 (1988).

72. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 525 (1984).

73. 11 U.S.C. § 1123(b)(5) (1982).

74. *Id.*

75. Reference to this provision will hereinafter be referred to as the "appropriate, not inconsistent" test. One of the concerns guarantors and courts alike might share in the pliable § 1123(b)(5) test is the potential for abuse that a blanket position of acceptance of injunctions might bring. For this reason, this note recognizes the importance of court discretion in the granting of such injunctions based upon the facts of each case. For an illustration of the differences of facts between cases, compare the facts in *In re* American Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989) to the facts in *Robins*.

which has been sought by courts sanctioning temporary injunctions.[76]

In conformity with the "appropriate, not inconsistent" test, a court should assess a *Robins*-type injunction by using a two-prong threshold analysis. First, an injunction provision must pass an objective hurdle: *it must be included as a part of a plan of reorganization*, and otherwise be consistent with the terms of section 524(e) and other provisions of the Code.[77] Second, an injunction—in light of the potential for abuse—should not be approved unless in the opinion of the court it is "appropriate."[78] This appropriateness hurdle lends an essential element of discretion to the bankruptcy court which might otherwise fear a floodgate of unjustified requests for injunctions arising from this interpretation of the meaning of section 524(e).[79]

While case precedent concerning permanent injunctions is relatively sparse, as discussed earlier, another line of cases addresses temporary injunctions.[80] Temporary injunctions generally last only for the duration of the bankruptcy proceedings and prevent the waste and dissipation of the debtor's assets and the resulting failure of the reorganization because of funds spent on defending related debtors from creditor action that is not prohibited by the automatic stay.[81] Courts granting temporary injunctions in bankruptcy proceedings have provided criteria that are also useful when considering when a permanent injunction might be appropriate in terms of 11 U.S.C. section 1123(b)(5).

For example, in In re *Arrow Huss*[82] and In re *Family*

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76. *See supra* note 16 and accompanying text.

77. The reason a permanent injunction prohibiting suits by creditors against third-party debtors must be included in the reorganization plan is to overcome the hurdle of the language of § 524 which, as discussed previously, provides that such an injunction cannot be implemented by mere confirmation of a bankruptcy plan of reorganization. *See supra* text accompanying notes 26-28.

78. Among the factors to consider in determining the appropriateness of a given injunction might be the percentage to be paid to creditors under the plan, the popularity of the injunctive provision among creditors and the critical nature of the injunction to the success of the reorganization.

79. This note does not advocate the unrestricted use of an injunction limiting the liability of third-party debtors, nor does it purport to state that § 524(e) allows such a practice. Section 524(e), together with § 1123(b)(5), justifies the discretionary use of such injunctions in circumstances similar to the facts in *Robins*.

80. *See supra* notes 16-21 and accompanying text.

81. *Id.*

82. 51 Bankr. 853, 859 (Bankr. D. Utah 1985). *See also supra* notes 16-21 and accompanying text.

Health Services Corp.,[83] the respective courts offered three and four-part tests which, in their respective jurisdictions, govern the discretion of the court regarding granting temporary injunctions. In *Arrow Huss*, Judge Clark modified the four-part test required for the issuance of an injunction under Rule 65 of the Federal Rules of Civil Procedure to fit the bankruptcy context.[84] He concluded that the threshold test for determining when a temporary injunction should be granted requires satisfying three elements:

> (1) whether continuation of the litigation against the nondebtor would frustrate the ability of the debtor to develop and go forward with its plan of reorganization;
> (2) whether the debtor is close to having a confirmable plan that will fully satisfy the affected creditor's claims; [and]
> (3) whether the nondebtors' continuing efforts on behalf of the debtor are essential to prepare and carry out the provisions of the plan.[85]

Similarly, in *Family Health Services*, the court set forth the Ninth Circuit's four-part threshold test for the granting of temporary injunctive relief and required a showing of the following:

> (1) irreparable injury,
> (2) probable success on the merits,
> (3) a balance of hardships that tips in the movant's favor, and
> (4) that a preliminary injunction is in the public interest. Alternatively, a court may issue an injunction if the moving party demonstrates *either* a combination of probable success on the merits and irreparable injury *or* that serious questions are raised and the balance of hardships tips in his favor.[86]

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83. 105 Bankr. 937, 943 (Bankr. C.D. Cal 1989). *See also supra* notes 16-21 and accompanying text.

84. FED. R. CIV. PRO. 65 provides that a temporary injunction requires a showing of the following:

> (1) Substantial likelihood that the movant will eventually prevail on the merits;
> (2) A showing that the movant will suffer irreparable injury unless the injunction issues;
> (3) Proof that the threatened injury to the movant outweighs whatever damage the proposed injunction may cause the opposing party; and
> (4) A showing that the injunction, if issued, would not be adverse to the public interest.$f1

85. 51 Bankr. at 859.

86. 105 Bankr. at 943 (quoting F.T.C. v. Evans Prod. Co., 775 F.2d 1084, 1088-89 (9th Cir. 1985) (emphasis in original)). *See supra* text accompanying notes 82-85.

In analyzing the *Arrow Huss* and *Family Health Services* opinions, it is clear that courts hesitate to grant even a temporary injunction. This judicial hesitation is understandably compounded and extended in permanent injunction cases because of the significant difference in the duration of the injunction and the impact such permanence has on creditors and tort claimants. Thus, the following proposed permanent injunction "appropriate, not inconsistent" test may provide a guide for a court's analysis of when the granting of a permanent Robins-type injunction is proper.

4. The permanent injunction "appropriate, not inconsistent" test

In determining whether to grant or deny a request for a permanent injunction, the court should satisfy a two-part threshold analysis. The first prong requires the court to consider whether a certain injunction is consistent with section 524 and other sections of the Bankruptcy Code. This test could be easily satisfied if a reorganization plan provides for a permanent injunction prohibiting creditor suits against third party debtors. However, the second prong is the safety net and gives a court flexibility to grant or deny the effect of a permanent injunction depending on the particular facts and circumstances of the case.

In determining whether to uphold the validity of a *Robins*-type permanent injunction, the "appropriate" prong of the discretionary test might require the court to find that

> (1) there has been a determination, after notice and a hearing, that the remedy afforded creditors in lieu of continuing litigation rights is sufficient to meet creditors' needs;
> (2) the injunction is an essential element of the plan, without which there would be no similar recovery for creditors;
> (3) the reorganization is not feasible without the injunction; and
> (4) the overwhelming majority of creditors have voted to accept the injunction, voluntarily forsaking their rights to pursue third party debtors.

Of these factors, numbers two and three originate with Judge Clark's *Arrow Huss* temporary injunction test,[87] and the remaining two are taken from the unique facts found in *Robins*.

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87. *See supra* notes 82-85 and accompanying text.

While all four factors might well be considered in determining the appropriateness of granting a permanent injunction, the critical difference between the requisites for granting the temporary injunction verses the permanent injunction should rest with the creditors themselves because they stand to lose or gain the most by the injunction. If the creditors overwhelmingly vote to approve a reorganization plan containing a permanent injunction—as they did in *Robins*—and, if the other three (3) elements are met, the permanent injunction should be granted pursuant to the "appropriate, not inconsistent" standard of Section 1123(b)(5).

V. Conclusion

The Fourth Circuit in *Robins* was given an enviable chance to establish a clear and solid precedent regarding the correct interpretation and use of section 524(e). AHP was a buyer willing to put up enough money to provide relief for the victims of the Dalkon Shield, and as the trial court found, the elements of the plan offered everything reasonably possible to the victims and creditors. However, in order for AHP to spend more than $3 billion on the Robins acquisition, it had to have an assurance of peace from further liability. The Fourth Circuit gave AHP and the Dalkon Shield claimants that assurance of peace, and in doing so gave claimants and creditors more money for satisfaction of their claims.

Inasmuch as section 524(e) of the Bankruptcy Code does not expressly prohibit the confirmation of a plan that enjoins creditors from pursuing claims against third party debtors, section 105(a) gives power to bankruptcy courts to permit such injunctions. Section 1123(b)(5) adds an "appropriate, not inconsistent" discretionary restriction to that section 105 power. The section 1123(b)(5) two-part threshold analysis provides an otherwise hesitating court with a safe and predictable guide that will provide for confirmation of bankruptcy plans that otherwise might not be confirmed, without taking away a court's power to prevent an abuse of injunction provisions. Such practice, while expanding the power of the injunction shield, will result in the use of the Bankruptcy Code for a more equitable end which, after all, is its purpose.

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