Clients&FriendsMemo

Fifth Circuit Holds that Gatekeeping and Injunction Provisions in Bankruptcy Plans Cannot Shield Non-Debtors From Liability.

March 26, 2025

On March 18, 2025, the United States Court of Appeals for the Fifth Circuit held in *In re Highland Capital Mgmt., L.P.,* that a plan's gatekeeping and injunction provisions could not extend to claims against most non-debtors or non-estate fiduciaries. 2025 WL 841189 (5th Cir. Mar. 18, 2025). The *Highland* decision demonstrates that, at least in the Fifth Circuit, gatekeeping and injunction provisions cannot shield most non-debtors from liability.

Background

Highland Capital Management, previously a $13 billion investment fund, filed for chapter 11 protection in 2019. The unsecured creditors committee and the debtor's independent directors proposed a chapter 11 plan that included three provisions intended to shield various parties from liability:

- *First*, the plan included an exculpation provision, which extinguished claims against the "Exculpated Parties" based on their actions in negotiating and implementing the plan, except for any acts that constitute bad faith, gross negligence, or willful misconduct. The plan defined "Exculpated Parties" to include the debtor, the unsecured creditors committee and its members, independent directors of the debtor, the litigation and claimant trusts, the debtor's chief restructuring officer, the debtor's general partner, professionals of the debtor and unsecured creditors committee, and related persons for each of the foregoing.

- *Second*, the plan included an injunction provision prohibiting holders of claims against or equity interests in the debtor from taking any "actions to interfere with the implementation or consummation" of the plan.

- *Third*, the plan included a "gatekeeper" clause, prohibiting creditors and equity holders from commencing or pursuing any claim arising from the chapter 11 case against the "Protected Parties" (defined to include substantially the same entities as those included as "Exculpated Parties") without first obtaining authorization from the Bankruptcy Court to

> pursue such claims. This "gatekeeper" provision provided that prior to commencing any such action, the Bankruptcy Court must first determine that the claims are colorable.

Various parties objected to the plan and challenged the exculpation, injunction, and gatekeeping provisions. The Bankruptcy Court confirmed the plan and overruled these objections.

In the initial appeal, the Fifth Circuit reversed confirmation "only insofar as the plan exculpates certain non-debtors in violation of 11 U.S.C. § 524(e)" and removed all non-debtor entities that were not estate fiduciaries from the scope of exculpation provisions. *See In re Highland Capital Mgmt.*, 48 F.4th 419, 424 (5th Cir. 2022). As a result, the Fifth Circuit ordered that the plan was only to include the debtor, the debtor's independent directors, the unsecured creditors committee and its members, and all related persons as "Exculpated Parties." The Court otherwise "affirm[ed] on all remaining grounds."

The appellants—certain investment funds—subsequently moved for panel rehearing, requesting that the Court clarify whether its holding applied to the definition of the term "Protected Parties" used in the plan's injunction and gatekeeping provisions. The Court granted rehearing, and deleted a sentence in its original opinion that stated that the "injunction and gatekeeper provisions are . . . perfectly lawful."

Thereafter, the debtor amended the plan to strike the non-debtor entities from the "Exculpated Parties" defined term, but the debtor did not seek any amendments to the "Protected Parties" defined term. As such, the gatekeeping and injunction provisions continued to shield non-debtor entities from liability. The investment firms (who were appellants in the first appeal) again objected to the plan on the basis that the term "Protected Parties" impermissibly included non-debtor entities. The Bankruptcy Court again confirmed the plan over the investment firms' objection. The Bankruptcy Court's decision preceded the Supreme Court's decision in *Harrington v. Purdue Pharma*, which held that non-consensual third-party releases are impermissible. The investment firms appealed again.

The Fifth Circuit's Decision

This time, the Fifth Circuit again reversed the Bankruptcy Court's confirmation order, finding that the Bankruptcy Court exceeded its authority in approving the plan's gatekeeping and injunction provisions. Citing the Supreme Court's recent decision in *Harrington v. Purdue Pharma*, the Fifth Circuit found that the Bankruptcy Code "does not authorize a release and injunction that, as part of a plan of reorganization under Chapter 11, effectively seeks to discharge claims against a non-debtor without the consent of the affected claimants."

The Fifth Circuit also held that "bankruptcy injunctions, though not in themselves releases, similarly act to shield persons and entities from liability and therefore may not be entered to protect non-

debtors not legally entitled to release." Moreover, even though section 105(a) of the Bankruptcy Code gives bankruptcy courts "a range of powers," the Court found that those powers are not unlimited and must be consistent with the Bankruptcy Code. Under section 524(e) of the Bankruptcy Code, "a discharge of a debt of the debtor" may not "affect the liability of any other entity on . . . such debt."

Even though the Fifth Circuit acknowledged that bankruptcy courts "have some power to perform gatekeeping functions," they do not have "unrestricted power to protect non-debtors from liability via a pre-filing injunction." According to the Fifth Circuit, permissible forms of gatekeeping include: (i) preventing a usurpation of the bankruptcy court's powers to distribute "trust assets to creditors equitably"; and (ii) shielding the bankruptcy trustee from personal liability for acts taken within the "scope of his official duties." But the Fifth Circuit found that this gatekeeping function should not be extended to "give bankruptcy courts gatekeeping power over claims against non-debtors." *Id.*

The Fifth Circuit held that its first *Highland* decision required the "bankruptcy court to narrow the definition of 'Protected Parties' used in the Gatekeeper Clause coextensively with the definition of 'Exculpated Parties'" used in the plan's exculpation provision. Specifically, the Fifth Circuit previously held that the plan violated section 524(e) of the Bankruptcy Code "insofar as it exculpates *and enjoins* certain non-debtors." Finally, in granting rehearing, the Fifth Circuit specifically struck language in the initial *Highland* opinion suggesting the validity of the gatekeeper and injunction provisions. Thus, the "Protected Parties" could only include the debtor, independent directors, and the unsecured creditors committee and its members.

Key Takeaways and Conclusions

- In the aftermath of the *Purdue Pharma* decision in which the Supreme Court limited the scope of non-consensual third-party releases, some speculated that plan injunction and gatekeeping provisions might provide a viable alternative to non-consensual third party releases. The *Highland* decision confirms that, at least in the Fifth Circuit, these non-release provisions cannot effectively shield most non-debtors from liability and may not function as a non-consensual third-party release.

- The Fifth Circuit found that although a plan injunction is not itself a release, the injunction shields entities from liability in a similar fashion and therefore cannot extend to most non-debtors.

- Bankruptcy courts in other circuits have recently confirmed plans that included gatekeeping provisions, which demonstrates that parties view these provisions as critical tools to control post-confirmation litigation. Recent examples include the chapter 11 plans for BlockFi (in the New Jersey Bankruptcy Court) and Spirit Airlines (pending in the

Bankruptcy Court for the Southern District of New York). Whether gatekeeping provisions will withstand scrutiny in other circuits remains to be seen.

- Parties may nevertheless seek to shield non-debtors through "opt-out" release provisions in a chapter 11 plan. The Bankruptcy Court for the Southern District of Texas recently approved "opt-out" provisions in the Container Store Group's bankruptcy, which is currently on appeal.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

Douglas S. Mintz	+1 202 862 2420	douglas.mintz@cwt.com
Casey J. Servais	+1 212 504 6193	casey.servais@cwt.com
Thomas J. Curtin	+1 212 504 6063	thomas.curtin@cwt.com