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**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

In re:	§	
	§	
Vision2Systems, LLC,	§	**Case No. 25-40583-MXM-11**
	§	
Debtor.	§	

United States Trustee's Objection to Disclosure Statement in Support of Plan of Liquidation of Vision2Systems LLC [related to ECF 125]

TO THE HONORABLE MARK X. MULLIN, U.S. BANKRUPTCY JUDGE:

Lisa L. Lambert, the United States Trustee for Region 6 ("United States Trustee"), objects to the *Disclosure Statement in Support of Plan of Liquidation of Vision2Systems LLC* (the "**Disclosure Statement,**" ECF 125). The United States Trustee would respectfully show:

SUMMARY

Vision2Systems, LLC (the "**Debtor**") provided online payment processing services to member churches but stopped operations in October 2024. Before the petition date, a number of churches filed lawsuits against the Debtor and its principals Paul Baldwin ("**Mr. Baldwin**") and Carl Tierney ("**Mr. Tierney**") alleging, among other things, gross mismanagement of funds. The Debtor now proposes a liquidating plan (the "**Plan**," ECF 124) which provides for the third-party release of Messrs. Baldwin and Tierney by those creditors who do not opt out of such releases. In exchange, Messrs. Baldwin and Tierney would contribute $10,000.00 to an initial general unsecured distribution fund (the "**Initial GUC Distribution Amount**") and $100,000.00 to a general unsecured settlement distribution pot (the "**GUC Settlement Distribution Amount**"). The United States Trustee objects to the Disclosure Statement because it describes a plan that is not confirmable and because the Disclosure Statement does not contain adequate information. Specifically:

- Section 11.7 of the Plan violates the United States Bankruptcy Code by imposing nonconsensual third-party releases (the "**Third-Party Releases**") on creditors who do not return ballots ("**Ballots**") with an "opt-out" election checked. Specifically, these Third-Party Releases release the Debtor but also the Post-Confirmation Debtor, Messrs. Baldwin and Tierney, as well as their respective "constituents, principals, officers, directors, employees, members, managers, managers, partners, affiliates, agents, representatives, attorneys, professionals, advisors, affiliates, funds, successors, predecessors, and assigns."[1]
- The Plan provides that Class 3 general unsecured creditors (the "**Class 3 Claimants**") who opt out the Third-Party Releases shall not be entitled to share in the pro rata in the GUC Settlement Distribution Amount.
- While the Debtor has not filed a solicitation procedures motion with proposed ballots or opt out forms, the Plan and Disclosure Statement contemplate sending creditors entitled to vote ballots and opt-out forms. The United States Trustee objects to such a proposed process to the extent that they impose Third-Party Releases without the releasing parties' affirmative, voluntary, and knowing consent under state law. The releases are thus nonconsensual and cannot be approved under recent Supreme Court precedent.

[1] See Plan § 2.2.71.

- The Plan does not provide for an independent third party to serve as post-confirmation trustee but instead provides for Mr. Baldwin to manage and wind down the Post-Confirmation Debtor.
- The Plan should specify that the Plan does not release claims of governmental entities exercising their police and regulatory authority.
- The Disclosure Statement also fails to include adequate information in the liquidation analysis (the "**Liquidation Analysis**") by failing to include possible recoveries that a chapter 7 trustee might obtain against Messrs. Baldwin or Tierney.

Jurisdiction

1. The Court has subject matter jurisdiction under 28 U.S.C. § 1334, 28 U.S.C. § 157(a)(1), and the standing order of reference. Conversion or dismissal under 11 U.S.C. § 1112(b) or the appointment of a chapter 11 trustee impacts case administration and therefore are core matters that the Court has the power to resolve. 28 U.S.C. § 157(b)(2)(A).

FACTS

Debtor files chapter 11 bankruptcy

1. On February 19, 2025, ("Petition Date"), Vision2Systems, LLC ("Debtor") filed a voluntary chapter 11 petition in the Northern District of Texas, commencing case number 25-40583-MXM-11.

2. From 2012 through 2024, the Debtor provided member churches a digital platform through which congregants could donate funds to support their churches and ministries. ECF 5[2] at 2-3.

3. Messrs. Baldwin and Tierney are the Debtor's managers. ECF 1 at 5.

[2] *Declaration of Paul Baldwin in Support of Debtor's Chapter 11 Petition and Requests for First Day Relief* [ECF 5].

4. The Debtor stopped operations in October 2024 because of cash flow problems and issues with accounting for and processing donations for its member churches.

5. Several of these member churches alleged that the Debtor did not turn over all the donations to which they were entitled.

6. As of the Petition Date, the Debtor was a defendant in four lawsuits:

a. *Saddleback Valley Community Church v. Vision2 Systems, et al.,* Case No. 3:24-cv-02700 (N.D. Tex.)("Saddleback Suit")

b. *The Crossing Church v. Vision2Systems, et al,* Case No. DC-24-18092 (116th Jud. District Court for Dallas County)("Crossing Church Suit").

c. *Resurrection Metropolitan Community Church v. Vision2Systems, LLC, et al,* Cause No. 2024-69700 (234th District Court Harrison County)("Resurrection Suit"); and

d. *Chrisian Fellowship Church v. Vision2Systems, LLC, et al,* Cause No. DC-25-00011 (68th District Court Dallas County)("Christian Fellowship Suit").

7. Northridge Church subsequently intervened as a plaintiff in the Crossing Church Suit. ECF 5 at 6.

8. Messrs. Tierney and Baldwin are also defendants in each of these lawsuits.

9. These four lawsuits allege, among other things, breach of contract, breach of fiduciary duty, unjust enrichment, and fraud. ECF 5 at 5-7.

10. The Debtor blames its cash flow problems on several outside factors including 1) advancing donations to member churches on transactions that were later reversed, 2) former payment processor Wells Fargo's failure to timely send error files to the Debtor in the proper

format, and 3) over withholding settlement fees on donations funded by certain credit cards, rather than the Debtor's own failure to properly account for the donations.

United States Trustee's Motion to Convert

11. On April 11, 2025, the United States Trustee filed her *Motion to Convert to Chapter 7 under 11 U.S.C. § 1112(b), or, in the Alternative, for the Appointment of a Chapter 11 Trustee under 11 U.S.C. § 1104(a)* (the "**Motion to Convert**," ECF 87).

12. The Motion to Convert argues that cause exists to convert the Debtor's case to chapter 7 because a) the Debtor is no longer operating and has no employees and b) appeared to have been filed in bad faith.

13. In the alternative, the Motion to Convert seeks the appointment of a chapter 11 trustee because a) former management either committed fraud, engaged in gross mismanagement, or were incompetent prior to the filing of the case and b) conflicts of interest between the Debtor's estate and Messrs. Baldwin and Tierney.

14. The Motion to Convert is set for hearing on September 22, 2025.

Disclosure Statement and Plan

15. The Debtor filed the Plan and Disclosure Statement on August 11, 2025.

16. A hearing on the Disclosure Statement is set before this Court on September 22, 2025.

17. The Plan provides for the following classes and treatment:

Class	Treatment	Estimated Amount	Proposed Distribution
Class 1: CGC Secured Claims	Impaired	$100,000	100% on effective date
Class 2: SBA Secured Claim	Impaired	$0	Zero
Class 3: General Unsecured Claims	Impaired	$6,100,000	Either 1) pro rata share of Initial GUC Distribution Amount and/or 2) pro rata share of the GUC Settlement Distribution Amount

Class 4: Insider Claims	Impaired	$298,130.52	Zero
Class 5: Equity Interests	Impaired	N/A	Zero

18. The Disclosure Statement estimates that total Class 3 Claimants are owed $6.1 million, but notes that these amounts may also be subject to setoff.

19. The Class 3 Claimants are primarily former member churches.

20. The Plan provides for the payment of Class 3 General Unsecured Claims from two pots: a) the Initial GUC Distribution Amount of $10,000.00 and b) the GUC Settlement Distribution Amount of $100,000.

21. The Debtor asserted on Amended Schedule A/B that, as of the petition date, it had overpaid member churches $6,360,317.00. ECF 81.

22. To date, forty-six (46) proofs of claim have been filed in this case totaling $8,992,813.65 in claims, of which $759,024.91 are secured and $6,083.75 are priority unsecured claims.

23. Section 6.2 of the Plan is a Rule 9019 settlement that provides for the "compromise, settlement, and release of all potential claims against Baldwin and Tierney" (the "9019 Settlement").

24. Under the 9019 Settlement, the Debtor and all Class 3 Claimants who do not opt out of the release would release all potential claims against Messrs. Baldwin and Tierney. Plan § 6.2(a) and (b).

25. In exchange for this release, Messrs. Baldwin and Tierney would fund the Initial GUC and GUC Settlement Distribution Amounts; waive an aggregate of $298,130.52 in prepetition claims against the estate; and release the Debtor and Post-Confirmation Debtor. Plan § 6.2(a)-(c).

26. The Post-Confirmation Debtor (the "**Post-Confirmation Debtor**") is "the legal entity that shall survive the Debtor as of the Confirmation Date." Plan § 2.2.70.

27. The Plan shall go effective the first business day (the "**Effective Date**") after the following conditions are met:

> (a) The Confirmation Order shall have become a Final Order; and
>
> (b) All other actions, documents, and agreements necessary to implement the Plan shall have been effected or executed.

Plan § 6.6.

28. The Plan also provides for the winddown and dissolution of the Debtor after the Effective Date, with Mr. Baldwin serving as the Post-Confirmation Debtor's authorized representative. Plan § 6.4.

29. Section 2.2.71 of the Plan defines "Released Parties" as:

> 2.2.71 Released Parties. Means the Debtor, the Post-Confirmation Debtor, Baldwin, Tierney, and each of their respective constituents, principals, officers, directors, employees, members, managers, partners, affiliates, agents, representatives, attorneys, professionals, advisors, affiliates, funds, successors, predecessors, and assigns.

30. Section 2.2.72 of the Plan defines "Releasing Parties" as:

> 2.2.72 Releasing Parties. Means all parties who are entitled, directly or indirectly, to receive a distribution under the Plan, and who have not specifically opted out of this release on the Ballot by submitting the Ballot prior to the Voting Deadline in the manner set forth in the Ballot itself.

31. Section 11.6 of the Plan provides for the following third-party release (the "**Third Party Release**"):

11.7 Releases by Holders of Claims and Interests. **Notwithstanding anything contained in this Plan to the contrary, on and after the Effective Date, in exchange for good and valuable consideration, the adequacy of which is hereby confirmed, each Released Party is, and is deemed to be, hereby conclusively, absolutely, unconditionally, irrevocably and forever, released and discharged by each Releasing Party from any and all Claims and Causes of Action, in each case on behalf of themselves and their respective successors, assigns, and representatives, and any and all entities who may purport to assert any Claim or Cause of Action, directly or derivatively, by, through, for, or because of the foregoing entities, from any and all Claims and Causes of Action, including any derivative claims, asserted or assertable on behalf of any of the foregoing entities, whether known or unknown, foreseen or unforeseen, matured or unmatured, existing or hereafter arising, in law, equity, contract, tort, or otherwise, including any derivative claims asserted or assertable on behalf of the Debtor, the Post-Confirmation Debtor, or its Estate, that such entity would have been legally entitled to assert (whether individually or collectively) or on behalf of the Holder of any Claim against, or Interest in, a Debtor, a Post-Confirmation Debtor, or its Estate or other entity, based on or relating to, or in any manner arising from, in whole or in part, the Debtor (including the capital structure, management, ownership, or operation thereof), the purchase, sale, or rescission of any security of the Debtor or the Post-Confirmation Debtor, the subject matter of, or the transactions or events giving rise to, any Claim or Interest that is treated in this Plan, the business or contractual arrangements between or among the Debtor and any Released Party, the ownership and/or operation of the Debtor by any Released Party or the distribution of any Cash or other property of the Debtor to any Released Party, the assertion or enforcement of rights or remedies against the Debtor, the Debtor's in- or out-of-court restructuring efforts, any Avoidance Actions, the Bankruptcy Case, the formulation, preparation, dissemination, negotiation, or filing of the Plan, any other Definitive Documents, or any restructuring related transaction, contract, instrument, release, or other agreement or document (including any legal opinion requested by any entity regarding any transaction, contract, instrument, document or other agreement contemplated by the Plan or the reliance by any Released Party on the Plan or the Confirmation Order in lieu of such legal opinion) relating to any of the foregoing, created or entered into in connection with the Plan, before or during the Bankruptcy Case, any preference, fraudulent transfer, or other avoidance claim arising pursuant to chapter 5 of the Bankruptcy Code or other applicable law, the filing of the Bankruptcy Case, the pursuit of Confirmation, the pursuit of the Effective Date, the administration and implementation of the Plan, including the issuance or distribution of securities pursuant to the Plan, or the distribution of property under the Plan or any other related agreement, or upon any other act or omission, transaction, agreement, event, or other occurrence related or relating to any of the foregoing taking place on or before the Effective Date. For the avoidance of any doubt, the releases set forth in this Section above shall include, without limitation, any and all claims and causes of action against each Released Party for: breach of contract, breach of fiduciary duty, misapplication of fiduciary property, conspiracy, conversion, negligence, gross negligence, conversion, embezzlement, fraud, fraudulent inducement, fraudulent transfer, theft, assumpsit for money had and received, unjust enrichment, piercing the corporate veil, constructive trust, alter ego, single business entity, quantum meruit, violations of Deceptive Trade Practices Act, and violation of Deceptive Trade Practices Act Tie-in Statutes.**

> **Entry of the Confirmation Order shall constitute the Bankruptcy Court's approval, pursuant to Bankruptcy Rule 9019, of the Third-Party Release, which includes by reference each of the related provisions and definitions contained herein, and, further, shall constitute the Bankruptcy Court's finding that the Third Party Release is: (a) consensual; (b) essential to the Confirmation of the Plan; (c) given in exchange for the good and valuable consideration provided by each of the Released Parties, including, without limitation, the Released Parties' substantial contributions to facilitating the implementing the Plan; (d) a good faith settlement and compromise of the Claims released by the Third-Party Release; (e) in the best interests of the Debtor and its Estate; (f) fair, equitable, and reasonable; (g) given and made after due notice and opportunity for hearing; and (h) a bar to any of the Releasing Parties asserting any Claim or Cause of Action released pursuant to the Third-Party Release. <u>Notwithstanding anything to the contrary in the foregoing, the releases set forth above do not release any claims held by the Holder of any Class 3 Claim who has opted out of this release on the Ballot by submitting the Ballot prior to the Voting Deadline in the manner set forth in the Ballot itself.</u>**

32. The Plan is governed by Texas law. Plan § 14.9.

33. The Debtor did not file a motion for the approval of solicitation procedures with proposed ballots and opt-out provisions.

34. As of the date of filing of this Objection, the Debtor has failed to provide any form ballots, notices of non-voting status or other solicitation materials to any party.

35. The Plan and Disclosure Statement contemplate that creditors who opt out of the Third-Party Releases must submit ballots with the opt-out provision checked.

36. The Plan and Disclosure Statement contemplate that creditors who do not submit ballots are deemed to have consented to the Plan and Third-Party Releases.

37. The Disclosure Statement's liquidation analysis (the "**Liquidation Analysis**") provides that zero funds would be available to Class 3 Claimants through a chapter 7.

38. The Disclosure Statement does not take into account or otherwise estimate any recoveries that a chapter 7 estate might have against Messrs. Baldwin or Tierney.

OBJECTION

The Court should decline to approve the Disclosure Statement because the Plan is patently unconfirmable.

39. If there is a defect that renders a plan patently or inherently unconfirmable, the Court may consider and resolve that issue at the disclosure statement stage before requiring parties to proceed with solicitation of the plan and a contested confirmation hearing. *In re American Capital Equipment, LLC*, 688 F.3d 145, 153-54 (3d Cir. 2012). *See also, In re United States Brass Corp.*, 194 B.R. 420, 422 (Bankr. E.D. Tex. 1996).

40. The Court's equitable powers under 11 U.S.C. § 105 permit the Court to control its own docket and, therefore, to decline to approve a disclosure statement when the plan it supports may not be confirmable. *In re American Capital Equipment, LLC*, 688 F.3d at 154. A plan is patently unconfirmable when confirmation defects cannot be overcome by creditor voting and the confirmation defects relate to matters upon which the material facts are not in dispute or have been fully developed at the disclosure statement hearing. *Id*. at 154-55.

41. The Plan is patently unconfirmable because it contains impermissible release and injunction provisions. Approval of the Disclosure Statement in support of a plan with such impermissible terms would mean that a patently unconfirmable Plan would be solicited. And here, the solicitation procedures for which the Debtor seeks approval will actually facilitate certain of the Plan's flaws, because they include the opt-out provisions that will not establish actual consent to the Third-Party Release. Rather, the Court should require the Plan and Disclosure Statement be amended to remove and/or tailor the Third-Party Release and Injunction Provision so that they comply with applicable law. The Plan is also not confirmable because it does not provide for an independent third party to serve as post-confirmation trustee.

The Third-Party Releases

Nonconsensual plan releases of non-debtor third parties by non-debtor third parties are not authorized under the United States Bankruptcy Code.

42. The Supreme Court held in *Harrington v. Purdue Pharma L.P.* that bankruptcy courts cannot involuntarily alter relationships between non-debtors by imposing nonconsensual releases of, or injunctions barring, claims between them. 603 U.S. 204, 209, 227 (2024) ("*Purdue*"). The Court did not prohibit chapter 11 plans from memorializing consensual third-party releases, and it did not "express a view on what qualifies as a consensual release." *Id*. at 226. This has long been the conclusion held by the Fifth Circuit Court of Appeals. *See Bank of N.Y. Trust Co. v. Off'l Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009) (observing that prior Fifth Circuit authority "seems broadly to foreclose non-consensual non-debtor releases and permanent injunctions") ("*Pacific Lumber*").

43. A consensual third-party release is a separate agreement between non-debtors governed by nonbankruptcy law. As the Supreme Court recognized in *Purdue*, a release is a type of settlement agreement. *Purdue*, 603 U.S. at 223 (explaining that what the Sacklers sought was not "a traditional release" because "settlements are, by definition, consensual") (cleaned up). A bankruptcy court can acknowledge the parties' agreement to a third-party release, but the authority for a consensual release is the agreement itself, not the Bankruptcy Code. If a claim has been extinguished by virtue of the agreement of the parties, then the court is not using the forcible authority of the Bankruptcy Code or the bankruptcy court to extinguish the property right.

44. Here, there is no existing release agreement between non-debtors. The Debtor instead seeks a confirmation order that would use the power of the court to impose a third-party release on claimants without their affirmative and voluntary consent. Such a confirmation order would

impermissibly alter the relations between non-debtors because a valid release does not exist under nonbankruptcy law.

45. Three inconsistent tests have been suggested for determining whether a third-party release included in a bankruptcy court order is consensual: (1) it is only consensual when there is valid consent under applicable state contract law[3]; (2) parties who do not opt out can be deemed to have consented because class-action settlements are binding on those who do not opt out[4]; and (3) parties can be deemed to have consented the same way that a litigant may forfeit rights by failing to timely respond in litigation.[5]

46. The first test is the correct one. State law governs whether non-debtors have agreed to release each other. Nothing in the Bankruptcy Code allows parties to disregard state law when debtors seek to impose third-party releases in their plans. Under Texas law, as in other states, silence is not acceptance of an offer other than in limited circumstances inapplicable here. The Debtor thus cannot deem those claim and equity holders who fail to opt out of the Third-Party Release to have released claims because those claimants have not agreed to the Third-Party Release under state law.

<u>State Contract Law Applies, Not Federal Law</u>

47. "[T]he basic federal rule in bankruptcy is that state law governs the substance of claims." *Travelers Cas. & Sur. Co. of America v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450-451 (2007) (cleaned up); *accord Butner v. United States*, 440 U.S. 48 (1979). Thus, courts apply state law

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[3] *See, e.g., In re Smallhold, Inc.*, 665 B.R. 704, 720 (Bankr. D. Del. 2024); *Emerge Energy Services, LP,* No. 19-11563, 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019); *In re Digital Impact, Inc.*, 223 B.R. 1, 14-15 (Bankr. N.D. Okla. 1998); *In re Arrowmill Dev. Corp.,* 211 B.R. 497, 507 (Bankr. D.N.J. 1997).

[4] *See, e.g., In re Robertshaw US Holding Corp.,* 662 B.R. 300, 323 n.120 (Bankr. S.D. Tex. 2024).

[5] *See, e.g., In re Arsenal Intermediate Holdings, LLC*, No. 23-10097, 2023 WL 2655592, at *5-*6 (Bankr. D. Del. Mar. 27, 2023), *abrogated by Smallhold, Inc.*, 665 B.R. at 716; *In re LATAM Airlines Grp. SA*, 2022 WL 2206829, at *46 (Bankr. S.D.N.Y. June 18, 2022); *In re Mallinckrodt PLC*, 639 B.R. 837, 879-80 (Bankr. D. Del. 2022).

when the question is whether a debtor has entered a valid settlement agreement. *See Houston v. Holder (In re Omni Video, Inc.)*, 60 F.3d 230, 232 (5th Cir. 1995) ("Federal bankruptcy law fails to address the validity of settlements and this gap should be filled by state law."); *De La Fuente v. Wells Fargo Bank, N.A. (In re De La Fuente)*, 409 B.R. 842, 845 (Bankr. S.D. Tex. 2009) ("Where the United States is not a party, it is well established that settlement agreements in pending bankruptcy cases are considered contract matters governed by state law.").

48. The rule is no different for third-party releases. They are separate agreements between non-debtors governed by state law. Unlike a bankruptcy discharge, which "is an involuntary release by operation of law," "[i]n the case of voluntary releases, the nondebtor is released from a debt, not by virtue of 11 U.S.C. § 1141(b), but because the *creditor agrees to do so*." *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 503, 507 (Bankr. D.N.J. 1997) (emphasis in original). *See also Continental Airlines Corp. v. Air Line Pilots Assn., Int'l (In re Continental Airlines Corp.)*, 907 F.2d 1500, 1508 (5th Cir. 1990) (holding that for settlement provisions "unrelated to substantive provisions of the Bankruptcy Code," "the settlement itself is the source of the bankruptcy court's authority"). Thus, "the Bankruptcy Code has not altered the contractual obligations of third parties, the parties themselves have so agreed." *Arrowmill*, 211 B.R. at 507.

49. Because the Bankruptcy Code does not authorize the imposition of an involuntary release, *Purdue*, 603 U.S. at 209, 227, the release must be consensual under non-bankruptcy law. There is no Bankruptcy Code provision that preempts otherwise applicable state contract law governing releases between non-debtors. *See, e.g., Shady Grove Orthopedic Assocs. v. Allstate Ins. Co.*, 559 U.S. 393, 416 (2010) (plurality) ("For where neither the Constitution, a treaty, nor a statute provides the rule of decision or authorizes a federal court to supply one, 'state law must govern because there can be no other law.'") (quoting *Hanna v. Plumer*, 380 U.S. 460, 471-72 (1965));

Erie R. Co. v. Tompkins, 304 U.S. 64, 78 (1938) ("Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state."). Section 105(a), for example, "serves only to carry out authorities expressly conferred elsewhere in the code." *Purdue*, 603 U.S. at 216 n.2 (quotation marks omitted). But the Code does not confer any authority to impose a release of claims between non-debtors that would not be valid under state law. The Bankruptcy Code does not define a "consensual release." *See* 11 U.S.C. § 101. "There is no rule that specifies an 'opt out' mechanism or a 'deemed consent' mechanism" for third-party releases in chapter 11 plans. *In re Chassix Holdings, Inc.*, 533 B.R. 64, 78 (Bankr. S.D.N.Y. 2015). And no Code provision authorizes bankruptcy courts to deem a non-debtor to have consented to release claims against other non-debtors where such consent would not exist as a matter of state law.

50. Some courts have held that federal rather than state law applies to determine whether a third-party release is consensual. But because there is no applicable Code provision, whether a non-debtor has consented to release another non-debtor is not, as one court concluded, a "matter of federal bankruptcy law." *In re Spirit Airlines, Inc.*, No. 24-11988, 2025 WL 737068, at *18, *22 (Bankr. S.D.N.Y Mar. 7, 2025); *see also In re Robertshaw US Holding Corp.*, 662 B.R. 300, 323 (Bankr. S.D. Tex. 2024) (relying on caselaw in the district rather than any provision of the Bankruptcy Code). Absent express authority in the Code, federal courts cannot simply make up their own rules for when parties have given up property rights by releasing claims. Bankruptcy courts cannot "create substantive rights that are otherwise unavailable under applicable law," nor do they possess a "roving commission to do equity." *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86, 92 (2d Cir. 2003) (quotation omitted). Indeed, nearly a hundred years ago, the Supreme Court rejected the notion that federal courts can displace state law as "an unconstitutional

assumption of powers by the Courts of the United States which no lapse of time or respectable array of opinion should make us hesitate to correct." *Erie*, 304 U.S. at 79 (cleaned up); *accord Rodriquez v. FDIC*, 589 U.S. 132, 133 (2020) (holding state law applies to determine allocation of federal tax refund resulting from consolidated tax return). Courts thus may not invent their own rule for when parties may be "deemed" to have given up property rights by releasing claims.

51. In *In re 4 West Holdings, Inc.*, Judge Everett determined that because "there are no Federal Bankruptcy Rules or Federal Civil Rules that govern whether or not somebody can assent through silence to a deemed release" the Court must look to state law to determine whether opt out provisions are effective to confer consent to a third-party release. *See* Transcript of Proceedings before the Honorable Scott W. Everett held on October 18, 2022, on Motion to Enforce Confirmation Order and Releases and Injunctions Thereunder, Case No. 18-30777-SWE-11, United States Bankruptcy Court for the Northern District of Texas, Docket Entry No. 2086, p. 7 at ln. 1-6 (the "4 West Transcript").

52. Accordingly, state-law contract principles govern whether a third-party release is consensual. *See, e.g.*, *Patterson v. Mahwah Bergen Retail Grp., Inc.,* 636 B.R. 641, 684-85 (E.D. Va. 2022) (describing bankruptcy courts in the District of New Jersey as "look[ing] to the principles of contract law rather than the bankruptcy court's confirmation authority to conclude that the validity of the releases requires affirmative consent"); *In re Smallhold, Inc.*, 665 B.R. 704, 720 (Bankr. D. Del. 2024) (recognizing that "some sort of affirmative expression of consent that would be sufficient as a matter of contract law" is required); *In re SunEdison, Inc.,* 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017) ("Courts generally apply contract principles in deciding whether a creditor consents to a third-party release."); *Arrowmill*, 211 B.R. at 506, 507 (explaining that a third-party release "is no different from any other settlement or contract" and thus "the validity of

the release . . . hinge[s] upon principles of straight contract law or quasi-contract law rather than upon the bankruptcy court's confirmation order") (internal quotation marks omitted) (alterations in original). Because "'nothing in the bankruptcy code contemplates (much less authorizes it)' . . . any proposal for a non-debtor release is an ancillary offer that becomes a contract upon acceptance and consent." *In re Tonawanda Coke Corp.*, 662 B.R. 220, 222 (Bankr. W.D.N.Y. 2024) (quoting *Purdue*, 603 U.S. at 223). And "any such consensual agreement would be governed by state law." *Id.*

53. Even if federal law applied, however, it would not lead to a different result. That is because "federal contract law is largely indistinguishable from general contract principles under state common law." *Young v. BP Expl. & Prod., Inc. (In re Deepwater Horizon)*, 786 F.3d 344, 354 (5th Cir 2015) (cleaned up). *See also Deville v. United States*, 202 F. App'x 761, 763 n.3 (5th Cir. 2006) ("The federal law that governs whether a contract exists 'uses the core principles of the common law of contracts that are in force in most states.' . . . These core principles can be derived from the Restatements.") (quoting *Smith v. United States*, 328 F.3d 760, 767 n.8 (5th Cir. 2003)).

Under State Law, Silence Is Not Acceptance

54. The Debtor bears the burden to prove that the Plan is confirmable. *In re T-H New Orleans Ltd. Partnership,* 116 F.3d 790, 801 (5th Cir. 1997). It cannot meet this burden because it cannot establish that the Third-Party Release is consensual under applicable state law.

55. Under Texas law, like in other states, an agreement to release claims—like any other contract—requires a manifestation of assent to that agreement.[6] *See, e.g.*, RESTATEMENT

[6] While the Plan provides that its construction and enforcement is governed by the laws of the State of Texas, the Debtors cannot choose the law to apply to contracts between non-debtors. Rather, ordinary choice of law principles govern which state's law applies to contracts between non-debtors, although a choice of law analysis may not be necessary absent any assertion that there is a difference in potentially applicable state laws governing what constitutes consent. *See Smallhold*, 2024 WL 4296938, at *13 n.57.

(SECOND) OF CONTRACTS § 17(1) ("[T]he formation of a contract requires a bargain in which there is manifestation of mutual assent to the exchange and a consideration."); *Advantage Physical Therapy v. Cruse*, 165 S.W.3d 21 (Tex. App. 2005) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 69 (1981)).

56. Thus, "[o]rdinarily[,] an offeror does not have power to cause the silence of the offeree to operate as acceptance."[7] RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. a (1981). *See also Reichert v. Rapid Investments, Inc.*, 56 F.4th 1220, 1227 (9th Cir. 2022) ("[T]he offeror cannot prescribe conditions so as to turn silence into acceptance."); *Jacques v. Solomon & Solomon P.C.*, 886 F. Supp. 2d 429, 433 n.3 (D. Del. 2012) ("Merely sending an unsolicited offer does not impose upon the party receiving it any duty to speak or deprive the party of its privilege of remaining silent without accepting."); *Elfar v. Wilmington Trust, N.A.*, No. 20-0273, 2020 WL 7074609, at *2 n.3 (E.D. Cal. Dec. 3, 2020) ("The court is aware of no jurisdiction whose contract law construes silence as acceptance of an offer, as the general rule."), *adopted by* 2020 WL 1700778, at *1 (E.D. Cal. Feb. 11, 2021); *accord* 1 Corbin on Contracts § 3.19 (2018); 4 Williston on Contracts § 6:67 (4th ed.).

57. There are only very limited exceptions to the "general rule of contracts . . . that silence cannot manifest consent." *Patterson*, 636 B.R. at 686; *see also, e.g.*, See *Texas Ass'n of Ctys. Cty. Gov't Risk Mgmt. Pool v. Matagorda Cty.*, 52 S.W.3d 128, 131-33 (Tex. 2000) (quoting 2 Williston on Contracts § 6:49 (4th ed. 1991)**.** "[T]he exceptional cases where silence is acceptance fall into two main classes: those where the offeree silently takes offered benefits, and those where one party relies on the other party's manifestation of intention that silence may operate as

[7] Texas, like many states, follows the Restatement (Second) of Contracts § 69. See *Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 246 S.W.3d 42, 52 (Tex. 2008); *The Levin Law Grp., P.C. v. Sigmon*, No. 14-08-01165-CV, 2010 WL 183525, at *3 (Tex. App. 2010); *Texas v. Triax Oil & Gas, Inc.*, 966 S.W. 2d 123, 128 (Tex. App. 1998)**.**

acceptance. Even in those cases the contract may be unenforceable under the Statute of Frauds." RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. a.

58. But absent such extraordinary circumstances, "[t]he mere receipt of an unsolicited offer does not impair the offeree's freedom of action or inaction or impose on him any duty to speak." *Id.* And "[t]he mere fact that an offeror states that silence will constitute acceptance does not deprive the offeree of his privilege to remain silent without accepting." *Id.* § 69, cmt. c; *see also Patterson*, 636 B.R. at 686 (explaining how contract law does not support deeming consent based upon a failure to opt out); *Jacques*, 886 F. Supp. 2d at 433 n.3.

<u>Failing to Opt Out Does Not Provide the Required Affirmative Consent</u>

59. The Plan imposes the Third-Party Releases on anyone who is provided a Ballot and does not return it with the opt-out box checked. In other words, the Debtor seeks to impose an otherwise non-existent duty to speak on claimants regarding the offer to release non-debtors, and their silence—the failure to opt out—is "deemed" consent. But under black-letter law that silence is not acceptance of the offer to release non-debtors. *See, e.g.*, *Patterson*, 636 B.R. at 688 ("Whether the Court labels these 'nonconsensual' or based on 'implied consent' matters not, because in either case there is a lack of sufficient affirmation of consent").

60. A case from the Ninth Circuit illustrates the point. In *Norcia v. Samsung Telecom. Am., LLC*, 845 F.3d 1279, 1286 (9th Cir. 2017), cited with approval by the Third Circuit in *Noble v. Samsung Elec. Am., Inc.*, 682 F. App'x 113, 117-118 (3d Cir. 2017), and the Fifth Circuit in *Imperial Ind. Supply Co. v. Thomas*, 825 F. App'x 204, 207 (5th Cir. 2020), the court held that a failure to opt out did not constitute consent to an arbitration agreement. A consumer bought a Samsung phone and signed the Verizon Wireless Customer Agreement. *Norcia*, 845 F.3d at 1282. The phone came with a Samsung warranty brochure that contained an arbitration

provision but gave purchasers the ability to opt out of it without affecting the warranty coverage. *Id*. The customer did not opt out. *Id*. When the customer later sued Samsung, Samsung argued that the arbitration provision applied. *Id*. at 1282-83.

61. The Ninth Circuit in *Norcia* held that the customer's failure to opt out did not constitute consent to arbitrate. The court applied the "general rule," applicable under California law, that "silence or inaction does not constitute acceptance of an offer." *Norcia*, 845 F.3d at 1284 (quotation marks omitted); See *Texas Ass'n of Ctys. Cty. Gov't Risk Mgmt. Pool v. Matagorda Cty.*, 52 S.W.3d 128, 131-33 (Tex. 2000)**.** The customer did not agree to arbitrate because he did not "sign the brochure or otherwise act in a manner that would show his intent to use his silence, or failure to opt out, as a means of accepting the arbitration agreement." *Norcia*, 845 F.3d at 1285 (quotation marks omitted). This was true, even though the customer *did* take action to accept the offered contract from Verizon Wireless. "Samsung's offer to arbitrate all disputes with [the customer] cannot be turned into an agreement because the person to whom it is made or sent makes no reply, even though the offer states that silence will be taken as consent, unless an exception to this general rule applies." *Id*. at 1286 (quotation marks and citation omitted).

62. The Ninth Circuit held that none of the exceptions to this rule applied. *Norcia*, 845 F.3d at 1284-85. There was no state law imposing a duty on the customer to act in response to the offer, the parties did not have a prior course of dealing that might impose such a duty, and the customer did not retain any benefits by failing to act given that the warranty applied whether or not he opted out of the arbitration provision. *Id*. at 1286.

63. Here, too, the Debtor's creditors have not signed an agreement to release the non-debtor releasees nor acted in any other manner to suggest that their silence manifests an intention to accept an offer to release the non-debtors.

<u>Not voting and not opting out is not consent to release non-debtors</u>.

64. Third-party releases cannot be imposed on those who do not vote and do not opt out. *See Smallhold,* 665 B.R. at 709; *SunEdison*, 576 B.R. at 458–61; *Chassix*, 533 B.R. at 81–82; *In re Washington Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011). 442 B.R. 314, 355 (Bankr. D. Del. 2011). This applies both to those Voting Class creditors who simply abstain from voting or vote to reject the Plan but do not opt out and those Non-Voting Class interest holders who are not entitled to vote. There is no basis to infer consent by those who do not vote and are taking no action with respect to the Plan. Further, a creditor who rejects the Plan, but does not opt out of the Third-Party Release should not be held to the Third-Party Release because that creditor has rejected the Plan in full. A creditor who has rejected the Plan in full should not be required to then reject one provision of that already rejected plan Plan by way of the opt-out.

65. Even where there are conspicuous warnings that a party will be bound if they remain silent, that is not sufficient to recast a party's silence as consent to a third-party release. *SunEdison*, 576 B.R. at 458–61. Creditors have no legal duty to vote on a plan, much less to respond to an offer to release non-debtors included in a plan solicitation. *See, e.g.*, 11 U.S.C. § 1126(a) (providing that creditors "may" vote on a plan); *SunEdison,* 576 B.R. at 460–61 (recognizing that creditors have no duty to speak regarding a plan that would allow a court to infer consent to third-party releases from silence). Consent thus cannot be inferred from their silence because "[t]he mere fact that an offeror states that silence will constitute acceptance does not deprive the offeree of his privilege to remain silent without accepting." RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. c (1981). Nor can it "impose on him any duty to speak." *Id.* § 69 cmt. a.

66. Further, "[w]hen the circumstances are equally consistent with either of two facts, neither fact may be inferred." *See In re Couture Hotel Corp.*, 554 B.R. 369, 383 n.80 (Bankr. N.D. Tex. 2016). Consent thus cannot be inferred here because parties who are solicited but do not vote may have failed to vote for reasons other than an intention to assent to the releases.[8] *SunEdison*, 576 B.R. at 461.

67. "Charging all inactive creditors with full knowledge of the scope and implications of the proposed third-party releases, and implying a 'consent' to the third-party releases based on the creditors' inaction, is simply not realistic or fair and would stretch the meaning of 'consent' beyond the breaking point." *Chassix*, 533 B.R. at 81. "It is reasonable to require creditors to pay attention to what the debtor is doing in bankruptcy as it relates to the creditor's rights against the debtor. But as to the creditor's rights against third parties—which belong to the creditor and not the bankruptcy estate—a creditor should not expect that those rights are even subject to being given away through the debtor's bankruptcy." *Smallhold*, 665 B.R. at 721; *see also id.* at 719-20 (discussing *Chassix*). "A party's receipt of a notice imposing an artificial opt-out requirement, the recipient's *possible* understanding of the meaning and ramifications of such notice, and the recipient's failure to opt-out simply do not qualify" as consent. *Emerge Energy Services, LP*, No. 19-11563, 2019 WL 7634308, at *18 (Bankr. D. Del. Dec. 5, 2019) (emphasis in original). "[B]asic contract principles" require affirmative assent, not inferences drawn from inaction that in fact may reflect only "[c]arelessness, inattentiveness, or mistake." *Id.*

68. Thus, after the Supreme Court's decision in *Purdue*, one Court in the Northern District of Texas[9] addressed whether the failure to exercise an "opt-out" is effective to constitute consent to

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[8] Here, the Plan and associated materials, including the Disclosure Statement, run to more than 193 pages, which do not include the forthcoming Plan Supplement.

[9] *Ebix* and its predecessor, *In re 4 West Holdings, Inc.*, interpret the contract law of the State of Texas. The laws of the State of Texas have long held that silence does not equal consent sufficient to support the existence of a contract,

third party releases at confirmation and in the context of a motion to enforce a confirmation order.[10] In *In re Ebix, Inc.*, the Court denied the effectiveness of opt out third party releases for creditors who failed to return a ballot. In disallowing the inclusion of the third-party release in the proposed plan, the Court noted "[n]othing in the Bankruptcy Code or Bankruptcy Rules provides for such relief, and under Texas contract law, that the parties agree governs the third-party release under the Debtor's proposed plan, silence does not equal the consent of the affected claimants on this record." *See In re Ebix, Inc. et al*, Transcript of Ruling on Amended Chapter 11 Plan, before the Honorable Scott W. Everett held on August 2, 2024, Case No. 24-80004-SWE-11, United States Bankruptcy Court for the Northern District of Texas. (the "Ebix Transcript").

69. The *Ebix* ruling conforms to that Court's prior ruling on the permissibility and effectiveness of an opt out third-party release in *4 West Holdings*, where the court found that there had not been "a determination, either in the confirmation order or since, on whether, in fact, the opt-out releases are permitted by applicable law." *See 4 West* Transcript, pp. 5-6 at ln.19-2. *See* also *4 West* Transcript, p. 13 at ln. 22-23. Although in *Ebix* Judge Everett found those parties who returned a ballot—but failed to opt-out of the third-party release—consented to that release, the better view requires affirmative action to knowingly release third parties for the reasons discussed above.

70. In *Ebix*, the Court stated "[o]nce consent is viewed from a contractual perspective, though, it is exceedingly difficult to construe the failure to opt out of a third-party release as

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except under limited circumstances not applicable in this case. *See Texas Ass'n of Ctys. Cty. Gov't Risk Mgmt. Pool v. Matagorda Cty.*, 52 S.W.3d 128, 132-33 (Tex. 2000).

[10] As Judge Everett noted in *Ebix* and *4 West Holdings, Inc*., there are conflicting cases concerning the effectiveness of opt-out releases. *See Ebix* Transcript, p. 9 at 19, *4 West* Transcript, p. 3 at ln. 17-19. Judge Everett further noted that while no other bankruptcy judge in the Northern District of Texas had written on the issue, the other four judges in the Northern District of Texas had approved opt-out release structures and that he, respectfully, was parting ways with his colleagues. *See 4 West* Transcript, p. 6 at ln. 14-16, *Ebix* Transcript, p. 5, ln. 8-11.

valid consent." *Ebix* Transcript, p. 15, ln. 18-20. The Court found that silence does not equal consent under Texas contract law and that none of the three exceptions to that principle—that assent to contract is supported by the parties' course of conduct, that assent to contract arises where the offeree accepts the benefit of the offer, and that assent to contract exists where the offeree misleads the offeror and that the offeree, by remaining silent, intends to accept the offer—apply to the opt out provisions in *Ebix*. *See Ebix* Transcript p. 16-19, *See also 4 West* Transcript, pp. 18-19 at ln. 23 to 21.

71. Simply put, an "opt out mechanism is not sufficient to support the third-party releases . . . particularly with respect to parties who do not return a ballot (or are not entitled to vote in the first place)." *In re Washington Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011); *see also Chassix*, 533 B.R. at 81–82.

<u>Voting on a plan plus a failure to opt out does not manifest consent to a non-debtor release.</u>

72. The Disclosure Statement does not include a proposed form of ballot or opt-out notice. However, the Disclosure Statement contemplates a form of ballot with an opt-out provision.

73. Voting to accept a plan without checking an opt-out box does not constitute the affirmative consent necessary to reflect acceptance of an offer to enter a contract to release claims against non-debtors.[11] *See* RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. a (1981).

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[11] One bankruptcy court has found that, in at least some circumstances, a failure to opt out constitutes consent when a claimant votes—either to accept or reject a plan—but not if they do not vote. *See Smallhold,* 665 B.R. at 723. The *Smallhold* court incorrectly reasoned that because the act of voting on a debtor's plan is an "affirmative step" taken after notice of the third-party release, failing to opt out binds the voter to the release. *Id*. But while voting is an "affirmative step" with respect to the debtor's plan, it is not a "*manifestation of intention* that silence may operate as acceptance" of a third-party release. RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. a (1981) (emphasis added). That is because "[t]he mere receipt of an unsolicited offer does not impair the offeree's freedom of action or inaction," *id.*—in this case, the federal right to vote on a chapter 11 plan. 11 U.S.C. § 1126(a). Nor does it "impose on him any duty to speak,"

Voting to approve a plan plus a failure to opt out of a third-party release is nothing more than silence with respect to the offer to release claims against non-debtors. The act of voting on a chapter 11 plan without opting out is not conduct that "manifest[s] [an] intention that silence may operate as acceptance" of a proposal that the creditor release claims against non-debtors. RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. a. Impaired creditors have a federal right under the Bankruptcy Code to vote on a chapter 11 plan. 11 U.S.C. § 1126(a). Merely exercising that right does not manifest consent to release claims against non-debtors.

74. Even more obviously, those who vote to reject the plan are not consenting to third-party releases by failing to mark an opt-out box. Not only is there no "mutual agreement" as to the plan, much less the third-party release, the creditor has expressly stated its rejection of the plan. As the court in *In re Chassix Holdings, Inc.*, reasoned: "[A] creditor who votes to reject a plan should also be presumed to have rejected the proposed third-party releases that are set forth in the plan. *The additional 'opt out' requirement, in the context of this case, would have been little more than a Court-endorsed trap for the careless or inattentive creditor.*" 533 B.R. 64, 79 (Bankr. S.D.N.Y. 2015) (emphasis added).

75. This is especially concerning because the Debtor proposes differential treatment to Class 3 Claimants based on whether or not they opt out.[12] Specifically, as part of the settlement, Messrs. Baldwin and Tierney agreed that $100,000.00 of the GUC Settlement Distribution Amount are reserved for Class 3 Claimants so long as those claimants **do not** opt out of the Third-Party Release. Class 3 Claimants who do opt out preserve all rights against the Released

RESTATEMENT (SECOND) OF CONTRACTS § 69 cmt. a, such as by checking an opt out box.[11] Thus, consent to release *third-party* claims (which are governed by *nonbankruptcy* law) cannot properly be inferred from a party's failure to check an opt-out box on a ballot to vote on the proposed treatment of claims against the *debtor* (governed by *bankruptcy* law).

[12] Plan § 6.2(b).

Parties, but they also do not share in the entire reserve; instead, they would only receive a pro rata distribution from the $10,000.00 Initial GUC Distribution Amount. Because claimants who opt out of the releases are limited in the distributions they receive on account of their claims, their lack of an "opt out" cannot be characterized as voluntary consent. Rather, it reflects a punitive approach designed to suppress dissent and compel acquiescence through economic pressure. If an offeree is penalized unless an "offer" is accepted, that circumstance "preclud[es] an inference of assent." *Reichert v. Rapid Invs., Inc.*, 56 F.4th 1220, 1230-31 (9th Cir. 2022).

76. Moreover, by providing separate treatment for Class 3 Claimants depending solely on whether they opt out of the Third-Party Release, the Plan fails to treat Class 3 Claimants in the same manner as required by 11 U.S.C. § 11123(a)(4). While section 1123(a)(4) permits a claimant to consent to less favorable treatment, such consent should be affirmatively provided. 11 U.S.C. § 1123(a)(4).

There Is Insufficient Notice of the Third-Party Releases

77. Although as set forth above, a failure to opt out cannot provide affirmative consent, even if it could, the Third-Party Releases here cannot be approved because there was insufficient notice of them. Imputing state-law consent to a non-debtor release assumes that the creditor understands that failure to opt out will have this dramatic impact, which would require both that the creditor sees the non-debtor release provision and that the creditor understands its terms. But that assumption has no evidentiary support.

78. There is no acceptance of an offer when there is insufficient notice of the alleged contractual terms. *See Norcia*, 845 F.3d at 1285. "[A]n offeree, regardless of apparent manifestation of his consent, is not bound by inconspicuous contractual provisions of which he was unaware, contained in a document whose contractual nature is not obvious." *Id*. (quotation

marks omitted); *see also Noble v. Samsung Elec. Am., Inc.*, 682 F. App'x 113, 117-118 (3d Cir. 2017) (reaffirming that a person cannot be presumed to have agreed to contractual provisions unless "there is a reasonable basis to conclude that consumers will have understood the document contained a bilateral agreement"). Hence, failing to opt out does not reflect actual and knowing consent, particularly in the context of "an immensely complicated plan" where "it would be difficult for any layperson to comprehend all of its details." *In re Congoleum Corp.*, 362 B.R. at 194.

79. Furthermore, a failure to check a ballot opt-out box or return an opt-out form is not consent because—whether they are asked to vote or not—claimants have no reason to expect that an offer to contract with non-debtors will be included in the plan solicitation. As the Third Circuit has explained, there can be no presumption that someone has agreed to contractual provisions of which they are "on notice," unless "there is a reasonable basis to conclude that consumers will have understood the document contained a bilateral agreement." *See Noble v. Samsung Elec. Am., Inc.*, 682 F. App'x 113, 117-118 (3d Cir. 2017). *See also Norcia*, 845 F.3d at 1289 ("[N]o contract is formed when the writing does not appear to be a contract and the terms are not called to the attention of the recipient.") (quotation marks omitted).

80. Here, the Third-Party Release language is buried in the Disclosure Statement and Plan. The Debtor has not provided proposed forms of ballots or opt-out releases with the Disclosure Statement nor has it filed a motion for the approval of solicitation procedures. Parties in interest therefore cannot evaluate the proposed form of ballots and opt-out releases.

Opt-Outs Cannot Be Imposed Based on a Procedural Default Theory.

81. Applicable state contract law cannot be disregarded on a procedural default theory, applied by some courts, under which creditors who remain silent are held to have forfeited their

rights against non-debtors if they received notice of the non-debtor release but failed to object, just as they would forfeit their right to object to a debtor's plan if they failed timely to do so.[13] *See, e.g., In re Arsenal Intermediate Holdings, LLC*, No. 23-10097, 2023 WL 2655592, at *5-*6 (Bankr. D. Del. Mar. 27, 2023), *abrogated by Smallhold, Inc.*, 665 B.R. at 716; *In re Mallinckrodt PLC*, 639 B.R. 837, 879-80 (Bankr. D. Del. 2022); *In re DBSD North America, Inc.*, 419 B.R. 179, 218-19 (Bankr. S.D.N.Y. 2009), *aff'd on other grounds*, 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010), *rev'd in part and aff'd in part*, 634 F.3d 79 (2d Cir. 2011); *In re Robertshaw US Holding Corp.*, No. 24-90052, 2024 WL 3897812, at *17 (Bankr. S.D. Tex. 2024) (citing *Arsenal Intermediate Holdings, LLC*, 2023 WL 2655592, at *6-8)**]**. These courts reasoned that so long as the creditors received notice of a proposed non-debtor release and were informed of the consequences if they did not opt out or object to that release, there is no unfairness or deprivation of due process from binding them to the release. *Cf. Smallhold*, 665 B.R. at 708 (describing this reasoning as having treated a mere "failure to opt out" as "allow[ing] entry of the third-party release to be entered by default").

82. A fuller explanation of this theory was articulated prior to the *Purdue* ruling in *In re Mallinckrodt PLC*, 639 B.R. 837, 879-80 (Bankr. D. Del. 2022). The *Mallinckrodt* court stated that "the notion that an individual or entity is in some instances deemed to consent to something by their failure to act is one that is utilized throughout the judicial system." *Id*. "When a party to a lawsuit is served with a complaint or a motion, they need to file an answer or otherwise respond, or a judgment is automatically entered against them." *Id*. at 879. The court reasoned

[13] Although the court in *Spirit* disclaimed relying on a default theory, *Spirit Airlines,* 2025 WL 737068, at *17, it based its holding on the same rationale: that a party may be deemed to consent based on notice and a failure to respond, *id*. at *9-*10, *12-*13.

that "[t]here is no reason why this principle should not be applied in the same manner to properly noticed releases within a plan of reorganization." *Id*.

83. This is wrong. First, when a party in litigation is bound to a result based on a failure to timely respond, it is not because the defaulting party has *consented* to an adverse ruling. Rather, "failure to make timely assertion of [a] right before a tribunal having jurisdiction to determine it" results in *forfeiture* of the right. *United States v. Olano*, 507 U.S. 725, 731 (1993). Forfeiture, unlike waiver, is not an intentional relinquishment of a known right. *Id*. at 733. *Cf. Smallhold*, 665 B.R. at 718 ("In this context, the word 'consent' is used in a shorthand, and somewhat imprecise, way. It may be more accurate to say that the counterparty forfeits its objection on account of its default."). Forfeiture principles thus do not show consent.

84. Second, there is no basis to hold that parties have forfeited claims against non-debtor third parties based on their silence in response to a debtor's chapter 11 plan. No one has submitted the released claims for adjudication by the bankruptcy court. *See Olano*, 507 U.S. at 731.

85. And "[u]nder established principles," courts may enter relief against a party who has procedurally defaulted by not responding "only after satisfying themselves that the relief the plaintiff seeks is relief that is at least potentially available to the plaintiff" in contested litigation.[14] *Smallhold*, 665 B.R. at 709; *see also id*. at 722 ("[T]he obligation of a party served with pleadings to appear and protect its rights is limited to those circumstances in which it would be appropriate for a court to enter a default judgment if a litigant failed to do so."); *see also Thomson v. Wooster*, 114 U.S. 104, 113 (1885) (holding a decree *pro confesso* may only be entered if it "is proper to be decreed"); *Surtain v. Hamlin Terrace Found.*, 789 F.3d 1239, 1245

[14] As discussed further below, although the United States Trustee agrees with much of the analysis in *Smallhold*, she disagrees with its conclusion that voting on a plan combined with a failure to opt out constitutes consent.

(11th Cir. 2015) ("Entry of default judgment is only warranted when there is a sufficient basis in the pleadings for the judgment entered.") (cleaned up).

86. But a third-party release is not "an ordinary plan provision that can properly be entered by 'default' in the absence of an objection." *Smallhold*, 665 B.R. at 709. "It is unlike the listed cure amount where one can properly impose on a creditor the duty to object, and in the absence of such an objection bind the creditor to the judgment." *Id*. That is because, unlike for a creditor's claims against the debtor, the Bankruptcy Code affords no affirmative authority to order a release of claims against third parties. Because imposition of a nonconsensual non-debtor release is not relief available through a debtor's chapter 11 plan, it is not "appropriate to require creditors to object or else be subject to (or be deemed to 'consent' to) such a third-party release." *Id*. at 719-20.

87. Because a nonconsensual third-party release is "*per se* unlawful," it follows that a third-party release "is not the kind of provision that would be imposed on a creditor on account of that creditor's default." *Id*. at 709. And besides the flawed default theory, there is "no other justification for treating the failure to 'opt-out' as 'consent' to the release [that] can withstand analytic scrutiny." *Id*. Because a chapter 11 plan cannot permissibly impose non-debtor releases without the affirmative consent of the releasing parties, a release cannot be imposed based on their mere failure to respond regarding the non-debtor release.[15] Rather, an "*affirmative expression of consent* that would be sufficient as a matter of contract law" is required. *Id*. at 720 (emphasis added).

<u>Even if the Court Approves the Opt-Out Mechanism, the Post-Confirmation Debtor should be struck from list of Released Parties</u>

[15] For those reasons, the *Smallhold* court expressly disapproved of its prior decision in *Arsenal*, which had relied on the procedural default theory. *See id.* at 716 ("On the central question presented, the Court concludes that its decision in *Arsenal* does not survive *Purdue Pharma*.").

88. The Third-Party Release applies only to acts taking place on or before the Effective Date. The Post-Confirmation Debtor will not exist until on or after the Confirmation Date, when it comes into existence. Thus, at most, the Post-Confirmation Debtor would be entitled to a release only for any acts taken before or on the Effective Date, and not after. Given that the Post-Confirmation Debtor does not yet exist until such time as the Plan is confirmed, it should not be subject to the Third-Party Release after the Effective Date.

Plan should provide for an independent third party to manage the Post-Confirmation Debtor

89. The Plan provides that Mr. Baldwin will continue managing the Post-Confirmation Debtor. However, Mr. Baldwin may be conflicted from serving in such a role given that, prior to the bankruptcy filing, he was a co-defendant in various lawsuits in which former member churches alleged, among other things, gross mismanagement and/or fraud.

90. Given the Post-Confirmation Debtor's fiduciary rule in carrying out terms of a confirmed plan, an independent third-party, or an oversight committee, should manage and oversee the Post-Confirmation Debtor.

The Disclosure Statement and Plan should clarify that claims of governmental entities are not released.

91. The "police and regulatory power" exception to the automatic stay found at 11 U.S.C. § 362(b)(4) is designed to ensure that the stay "does not impede government's ability to protect public health and safety." *In re Wyly*, 526 B.R. 194, 198 (Bankr. N.D. Tex. 2015). Preserving governmental entities' ability to protect public health and safety is particularly important in the context of a healthcare company.

92. The Disclosure Statement does not contain adequate information as to whether governmental police and regulatory powers are preserved. The Debtor should modify the Disclosure Statement and Plan to clarify that no party shall be released from any causes of action or proceedings brought by any governmental entity in accordance with its regulatory functions, including but not limited to criminal and environmental matters. The United States Trustee requests that the Debtor include the following language in the Plan:

> Nothing in the Confirmation Order or the Plan shall effect a release of any claim by the United States Government or any of its agencies or any state and local authority whatsoever, including without limitation any claim arising under the Internal Revenue Code, the environmental laws or any criminal laws of the United States or any state and local authority against any party or person, nor shall anything in the Confirmation Order or the Plan enjoin the United States or any state or local authority from bringing any claim, suit, action, or other proceedings against any party or person for any liability of such persons whatever, including without limitation any claim, suit or action arising under the Internal Revenue Code, the environmental laws or any criminal laws of the United States or any state and local authority against such persons, nor shall anything in the Confirmation Order or the Plan exculpate any party or person from any liability to the United States Government or any of its agencies or any state and local authority whatsoever, including any liabilities arising under the Internal Revenue Code, the environmental laws or any criminal laws of the United States or any state and local authority against any party or person.

<u>The Disclosure Statement does not contain information on potential causes of action against the Debtor's principals</u>

93. Section 1125 of the Bankruptcy Code requires the plan proponent to include "adequate information" in the disclosure statement. 11 U.S.C. § 1125. The *Metrocraft* decision enumerated a list of non-exhaustive factors to consider when determining the adequacy of information contained within a disclosure statement is adequate. *In re Metrocraft Pub. Servs., Inc.,* 39 B.R. 567, 568 (Bankr. N.D. Ga. 1984). These factors include "financial information,

data, valuations or projects relevant to the creditors' decision to accept or reject the Chapter 11 plan." *Id.* at 568.

94. The Liquidation Analysis concludes that there would be no funds on hand for Class 3 Claimants if the Debtor were converted to chapter 7. However, the Liquidation Analysis does not take potential recoveries against Debtor's former management for gross mismanagement or fraud into account. Such information is relevant to any creditor's decision as to whether to accept or reject the Plan. As noted supra __, the Disclosure Statement is also deficient as no proposed ballots or notice of non-voting status were filed. At a minimum, these documents will need to be reviewed by creditors and parties in interest prior to solicitation.

CONCLUSION

The United States Trustee respectfully requests that the Court sustain her objection. The United States Trustee further respectfully requests that the Court grant any other relief to which she may be entitled.

DATED: September 15, 2025

Respectfully submitted,

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Certificate of Service

I certify that I sent copies of this motion on September 15, 2025, to all parties entitled to receive ECF notice in this case.

/s/ Erin Marie Schmidt
Erin Marie Schmidt