

11th Circuit Approves of Third-Party Releases Despite Debtor's Failure to Comply with Strict Notice Requirements of Bankruptcy Rules

Article By:

Shane G. Ramsey

Overview

Although a discharge might not release third parties and protects only the debtor against a determination of personal liability, in *In re Le Ctr. on Fourth, LLC*, 17 F.4th 1326 (11th Cir. 2021), the Eleventh Circuit recently validated third-party releases contained in the chapter 11 plan of Le Centre on Fourth ("Le Centre") that barred a claimant from proceeding to obtain recovery from the debtor's and third parties' insurers after plan confirmation. Although Rule 2002(c)(3) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") mandates specific noticing instructions when a chapter 11 plan provides for an injunction against conduct not otherwise enjoined under title 11 of the United States Code (the "Bankruptcy Code"), the Eleventh Circuit found that due process rights were not violated where the debtor provided actual notice of the third-party releases to its creditors despite failing to comply with the specific procedural requirements prescribed by the Bankruptcy Rules.

Background and Procedural History

While walking near one of Le Centre's hotels (the "Embassy"), Willie Jackson was struck by a hotel valet driver and suffered severe injuries. Mr. Jackson and his wife (together, the "Jacksons") brought a suit in Kentucky state court against the valet company and the driver. After commencing the initial state court action, the Jacksons amended their complaint to include Le Centre and two of its affiliates – the owner of Le Centre ("AJS") and the lessee of the hotel (the "Master Tenant")—as defendants. Le Centre was also a party to certain management agreements with Master Tenant and AJS, which contained indemnification provisions requiring Le Centre to indemnify such parties for, among other things, all losses relating to claims arising from the management of the Embassy.

Prior to the Jacksons amending their complaint to include Le Centre, AJS, and Master Tenant, Le Centre commenced a case under chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Florida (the "Bankruptcy Court"). Prior to Le Centre filing a disclosure statement, the Jacksons, through their attorneys, filed a motion in the chapter 11 case for relief from the automatic stay to allow the Kentucky state court action to continue against Le Centre solely to the extent any such liability thereon was covered by insurance. The Bankruptcy Court granted the motion.

During its chapter 11 case, Le Centre filed a proposed chapter 11 plan and disclosure statement, which contained a disclaimer, in all caps, advising and encouraging parties in interest to read the disclosure statement and plan in their entirety. The disclosure statement also included a section devoted to releases, which explained that any person who voted for the plan or abstained from voting would “be deemed to fully, completely, unconditionally, irrevocably, and forever release the Released Parties” from any claims that the person might have against such parties. The disclosure statement did not define “Released Parties” but noted that certain non-debtor parties, including individuals and entities that are affiliates of the current members and managers of Le Centre, would be released under the plan. The disclosure statement also provided that such non-debtor third parties would receive a discharge and injunction. Further, the plan that accompanied the disclosure statement contained a definition of “Released Parties” that included Le Centre and AJS but not Master Tenant.

Le Centre provided the Jacksons’ attorneys with (i) notice of the date for the confirmation hearing and deadline to object to the plan and (ii) copies of the disclosure statement and plan. The confirmation hearing notice, however, did not separately describe the terms of the releases contained in the plan or the identities of the parties that would be subject to the injunction.

At the confirmation hearing, the Bankruptcy Court confirmed Le Centre’s plan, including the third-party releases, finding that (i) Le Centre provided “adequate and sufficient notice” of the hearing and “other important information” to all parties in interest in compliance with the Bankruptcy Rules and (ii) the third-party releases were integral to Le Centre achieving a consensual reorganization. The Jacksons did not appear at the hearing or object to confirmation of the plan.

Following confirmation, Le Centre, AJS, and Master Tenant sought to dismiss the Kentucky state court action. In response, the Jacksons filed a motion with the Bankruptcy Court and argued that (i) neither the confirmation order nor the confirmed plan prevented the Jacksons from continuing to assert nominal claims against Le Centre, AJS, and Master Tenant to recover damages from their insurers and (ii) a release of the Jacksons’ claims in the state court action would violate their due process rights. With respect to due process, the Jacksons argued that Le Centre failed to comply with Bankruptcy Rule 2002(c)(3) because the confirmation hearing notice did not contain a separate brief description to inform parties about the nature of the plan injunction and the entities subject to that injunction. During the hearing, however, the Jacksons’ attorneys admitted that they did not read the plan or disclosure statement even though they received copies of them prior to confirmation.

The Bankruptcy Court denied the Jacksons’ motion finding that (i) the Jacksons’ due process rights were not violated because they received actual notice of the third-party releases when they received copies of the disclosure statement and plan and had a meaningful opportunity to be heard and (ii) the Jacksons could not assert nominal claims against Le Centre, AJS, or Master tenant.

The Jacksons appealed to the United States District Court for the Southern District of Florida, which affirmed the Bankruptcy Court’s decision. The Jacksons further appealed the decisions to the Court of Appeals for the Eleventh Circuit.

Eleventh Circuit’s Decisions

On appeal, the Court of Appeals for the Eleventh Circuit affirmed the decisions of the lower courts.

In reviewing the Jacksons’ due process argument, the Eleventh Circuit noted that due process requires notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.^[1]

Accordingly, the Eleventh Circuit considered whether the Jacksons' failure to receive notice of the third-party releases in compliance with the procedural requirements of Bankruptcy Rule 2002(c)(3) impacted their due process rights. In answering this question, the Eleventh Circuit relied on the Supreme Court's decision in *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260 (2010), which addressed whether a creditor's due process rights were violated based on the debtor's failure to strictly adhere to the procedural notice requirements prescribed by the Bankruptcy Rules. Similar to the Court in *Espinosa*, the Eleventh Circuit determined that actual notice was sufficient to satisfy due process, reasoning that the Jacksons did not object to Le Centre's failure to comply with Bankruptcy Rule 2002(c)(3) at or prior to the confirmation hearing. In so doing, the Eleventh Circuit found that the language incorporated into the disclosure statement and the plan provided the Jacksons with actual notice of the information that Bankruptcy Rule 2002(c)(3) required even though not in the form expressly contemplated by the Bankruptcy Rules and that was sufficient to satisfy due process:

"In this case, Le Centre provided the Jacksons with information that went well beyond the mere existence of a bankruptcy proceeding. The Second Amended Disclosure Statement included a four-page disclaimer advising the Jacksons to read the entire bankruptcy plan and specifically included a section on releases. The attached Second Amended Plan showed that Le Centre and AJS were included amongst the Released Parties. . . . [The] Jacksons received all the information required by Rule 2002(c)(3)—just not in the form contemplated by the Rule.

To sum up, the Jacksons received actual notice of the information that Bankruptcy Rule 2002(c)(3) required Le Centre to provide. The Supreme Court determined in *Espinosa* that actual notice is sufficient to satisfy due process, even where a debtor violates procedural requirements for supplying notice prescribed by the Bankruptcy Rules. We conclude, then, that the district court did not err in determining that the Jacksons suffered no due process violation.^[2]"

The Eleventh Circuit next addressed and rejected the Jacksons' alternative argument that even if the plan's discharge injunction was valid, the district court erred in not allowing the Jacksons to assert nominal claims against AJS and Master Tenant. With respect to AJS, the Eleventh Circuit found that the Jacksons were not permitted to nominally sue AJS because AJS did not have any insurance applicable to the Jacksons' claims.

With respect to Master Tenant, the Eleventh Circuit relied on *SuVicMon Development, Inc. v. Morrison*, 991 F.3d 1213 (11th Cir. 2021) and rejected the Jacksons' argument that section 524(e) of the Bankruptcy Code allowed the Bankruptcy Court to modify the plan's injunction for the Jacksons to assert nominal claims against Master Tenant. *SuVicMon* outlined the requirements a party must satisfy to assert a nominal claim against a discharged debtor to recover from such debtor's insurer. For a party to proceed nominally against a discharged debtor, (i) that party must be required to sue the debtor to recover against a third-party under applicable non-bankruptcy law and (ii) that party's suit against the debtor cannot economically burden the debtor so as to hinder the debtor's fresh start.

Here, the Eleventh Circuit found that the Bankruptcy Court did not abuse its discretion in denying the

Jacksons' ability to assert nominal claims against Master Tenant because doing so would "impose an economic burden on the debtor," given that Le Centre was required to indemnify Master Tenant for litigation costs under the parties' management agreements.

Conclusion

One of the key takeaways from the Eleventh Circuit's decision is that courts may, in certain circumstances, take a substance over form approach with respect to actual notice to satisfy due process even if a debtor fails to satisfy the specific procedural noticing requirements prescribed by the Bankruptcy Rules. Every situation, however, is unique and courts are likely to continue to apply a flexible standard when it comes to due process. For example, it is worth considering whether the Eleventh Circuit would have come out the same way had the Jacksons not been represented by counsel or if their counsel had not previously been involved in the chapter 11 case and admittedly not read the plan and disclosure statement. Going beyond the minimum noticing requirements is always a good rule of thumb for debtors especially when it comes to issues involving third party releases. However, this case is a good reminder that a debtor may still have arguments to enforce its discharge and injunction provisions (including against nominal claims), if it turns out it failed to strictly comply with any procedural noticing requirements.

ENDNOTES

[1] *Mullane v. Cent. Hanover Bank & Tr. Co.*, 339 U.S. 306, 314, 70 S. Ct. 652, 94 L. Ed. 865 (1950).

[2] *Le Ctr. on Fourth, LLC*, 17 F.4th at 1335–36 (internal citations omitted).

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