NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

In re: INVITAE CORPORATION, *et al.*, Debtors.	Bankruptcy Action No. 24-11362 (MBK)
OFFICIAL COMMITTEE OF UNSECURED CREDITORS, Appellant, v. INVITAE CORPORATION, DEERFIELD PARTNERS, L.P., U.S. BANK TRUST COMPANY, NATIONAL ASSOCIATION, and UNITED STATES TRUSTEE, Appellees.	Civil Action No. 24-8550 (RK) (CONSOLIDATED) **OPINION** **FILED UNDER TEMPORARY SEAL**

KIRSCH, District Judge

THIS MATTER comes before the Court upon Appellant Official Committee of Unsecured Creditors' ("Appellant" or the "Committee") appeal from (1) the United States Bankruptcy Court for the District of New Jersey's ("Bankruptcy Court") "Order Denying the Official Committee of Unsecured Creditors' Motion for (I) Leave, Standing, and Authority to Commence and Prosecute Certain Claims and Causes of Action on behalf of the Debtors' Estates,

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Case 3:24-cv-08550-RK Document 69 Filed 06/25/25 Page 2 of 24 PageID: 14261

and (II) Exclusive Settlement Authority" (Bankr. ECF No. 914, "Standing Order")[1]; and (2) the Bankruptcy Court's "Findings of Fact, Conclusions of Law, and Order Confirming the Third Amended Joint Plan of Invitae Corporation and its Debtor Affiliates Pursuant to Chapter 11 of the Bankruptcy Code" (Bankr. ECF No. 913, "Confirmation Order"). (ECF No. 1; ECF No. 11, "Comm. Br.") Briefs in opposition were filed by Appellees Invitae Corp. ("Invitae" or the "Company" or the "Debtor") (ECF No. 44, "Invitae Opp."), Deerfield Partners, L.P. ("Deerfield") (ECF No. 48, "Deerfield Opp."), and U.S. Bank Trust Company, National Association, as Trustee and Collateral Agent ("U.S. Bank") (ECF No. 46, "U.S. Bank Opp.") (collectively "Appellees"). The Committee replied. (ECF No. 60, "Comm. Rep.") The Court has considered the parties' submissions and resolves the matter without oral argument pursuant to Federal Rule of Civil Procedure 78 and Local Civil Rule 78.1. For the reasons set forth below, the Standing Order is **REMANDED**, and the Confirmation Order is **REMANDED** as to the Article VIII Debtor Release provision only.

I. BACKGROUND

This appeal concerns two decisions by the Bankruptcy Court. In the first decision, the Honorable Michael B. Kaplan (U.S.B.J.) denied a request by the Committee to stand in for the Debtor and bring a derivative action against creditors and other entities for a series of purportedly fraudulent prepetition transactions. (*See* Standing Order.) In the second decision, the Bankruptcy Court confirmed the final Bankruptcy Plan, which contained release provisions shielding a number of individuals and entities from liability in future actions brought by the Debtor—including the very entities that would have been the subject of the Committee's derivative lawsuit had it been

[1] References to "ECF No. __" refer to documents filed in this present appeal. References to "Bankr. ECF No. __" refer to documents filed in the Bankruptcy Court proceeding, *In re Invitae Corp.*, No. 24-11362 (Bankr. D.N.J.).

permitted to litigate. In both decisions, the Bankruptcy Court ruled against the Committee and in favor of the Appellees.

The record in this case—which spans more than 10,000 pages—is replete with characterizations and evidence of debtors, creditors, proposed credit exchanges, internal strategy meetings, board deliberations, advisory opinions, valuations, and bankruptcy plans. The Court summarizes herein only what is necessary to decide the present appeal.

Invitae is a medical genetics company that was founded in 2010 to "deliver[] genetic testing services, digital health solutions, and health data services." (AD0771 ¶¶ 2, 18.)[2] After years of growth, the Company made thirteen acquisitions between 2019 and 2021. (AD0787 ¶ 56.) To fund these acquisitions, Invitae entered into three primary transactions, raising a total of $1.635 billion. *First*, in 2019, Invitae issued $350 million of convertible unsecured notes—predominantly to Deerfield—set to come due on September 1, 2024 (the "2024 Unsecured Notes"). *Second*, in 2020, Invitae obtained a $135 million first term loan, set to come due on June 1, 2024. *Third*, in April 2021, Invitae issued an additional $1.15 billion in unsecured notes, set to come due on April 1, 2028 (the "2028 Unsecured Notes"), which were held by a wide variety of creditors. (*See* AD1330 ¶ 14; AD1376–AD1377; AD1472; AD1717.)

As 2024 drew near and Invitae became concerned with hundreds of millions of dollars in maturing debt, Invitae's board unanimously agreed to enter into an exchange of the 2024 Unsecured Notes that would come to be known as "The March Exchange."[3] (AD2171–AD2183.)

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[2] The record designated by Appellant is available at ECF Nos. 12-1 through 12-13. The record designated by Invitae is available at ECF Nos. 44-1 through 44-4. This Opinion cites to exhibits using pages in the record, not ECF numbers. Citations to documents filed by Appellant start with the prefix "A" and citations to documents filed by Invitae start with the prefix "AD," consistent with how the parties paginated the exhibits themselves.

[3] Appellant refers to this same transaction in its briefs as the "Uptier Transaction." (*See, e.g.*, Comm. Br. at 5.)

The March Exchange consisted of two parts: (1) Invitae exchanged $305.7 million in 2024 Unsecured Notes for $275.3 million in Series A 2028 Secured Notes, plus more than 14 million shares of common stock; and (2) Invitae issued $30 million in Series B 2028 Secured Notes (together with the Series A 2028 Secured Notes, the "2028 Secured Notes") for $30 million in cash. (A9471.) To be clear, this meant that Invitae was released of its obligation to pay back $305.7 million in 2024 Unsecured Notes that were coming due, and was now instead on the hook for approximately that same amount in *Secured* Notes that would come due in 2028. Although the new 2028 Secured Notes had a longer runway to pay back, they were also more valuable and would take priority in any future bankruptcy payout—if there were to be one.

Following the March Exchange, Invitae's financial situation did not improve. In August 2023, Invitae and Deerfield entered into another "privately negotiated exchange agreement" (A4291) to "further deleverage the Company" (Deerfield Br. at 10). This time, Deerfield exchanged approximately $17.2 million in 2024 Unsecured Notes for $100,000 in 2028 Secured Notes plus more than 15.8 million shares of the Company's common stock. (A4291.) No other parties were involved in this August Exchange.

Invitae's financial picture worsened as the Company barreled toward restructuring and third party sale. On February 13, 2024, Invitae filed a voluntary petition for Chapter 11 bankruptcy. (*See* Bankr. ECF No. 1.) On March 1, 2024, the United States Trustee appointed the Official Committee of Unsecured Creditors pursuant to Section 1102 of the United States Bankruptcy Code. (Bankr. ECF No. 131); *see* 11 U.S.C. § 1102(a)(1) ("[A]s soon as practicable . . . the United States trustee shall appoint a committee of creditors holding unsecured claims[.]"). Invitae filed its proposed Chapter 11 plan on May 9, 2024. (*See* Bankr. ECF No. 471; A0600–A0653.)

The Bankruptcy Plan followed the contours of a Transaction Support Agreement ("TSA") wherein Deerfield agreed to subordinate its secured claims to a group of small, unsecured claims in Invitae's bankruptcy. (*See* A4352.) Those with 2028 Secured Note claims, like Deerfield, who would typically be paid out before any unsecured creditor, would lose their preferred spot to those with small claims (known as the "Convenience Class Creditors") and to those who were unsecured creditors of Invitae's subsidiaries (known as the "Subsidiary Unsecured Creditors"). (*See* A4359–A4360.) Still, creditors with unsecured claims that fell outside the claims of the Convenience Class Creditors and Subsidiary Unsecured Creditors (like those with 2028 Unsecured Notes) would only receive what was left over after all creditors with priority were paid out.

The Committee, representing the Unsecured Noteholders, sought to take legal action on behalf of the Debtor in the form of a derivative action, to recover on what it believed was a series of fraudulent transactions effectuated by, *inter alia*, the March Exchange and August Exchange. Two decisions made by the Bankruptcy Court stood in their way: *first*, Judge Kaplan denied the Committee's motion for derivative standing, which would have allowed the Committee to sue on the Debtor's behalf. *Second*, Judge Kaplan confirmed a provision of the Plan that released all potential defendants in the derivative suit from liability. Without the power to sue, and no defendants available to be sued, the Committee appealed.[4] (ECF No. 1.)

II. LEGAL STANDARD

A district court has appellate jurisdiction over the final judgments, orders, and decrees of a bankruptcy court. 28 U.S.C. § 158(a)(1). A district court "may affirm, modify, or reverse a

[4] The Committee noticed its appeal on August 17, 2024. (ECF No. 1.) Initially, the two issues on appeal were noticed under different docket numbers: the Committee appealed the Bankruptcy Court's Confirmation Order in Case No. 24-8550 and appealed the Bankruptcy Court's Standing Order in Case No. 24-8555. (*See* ECF No. 3.) The two appeals were consolidated on October 1. (ECF No. 7.) The Committee filed its opening brief and exhibits (ECF Nos. 11, 12), Invitae filed a brief in opposition and exhibits (ECF No. 44), U.S. Bank filed a brief in opposition (ECF No. 46), and Deerfield filed a brief in opposition (ECF No. 48). The Committee replied and filed additional exhibits. (ECF Nos. 60, 62.)

bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." *See In re Cohn*, 54 F.3d 1108, 1113 (3d Cir. 1995) (quoting former Fed. R. Bankr. P. 8013); *see also In re Great Atl. & Pac. Tea Co., Inc.*, No. 14-4170, 2015 WL 6395967, at *2 n.1 (S.D.N.Y. Oct. 21, 2015) (although Fed. R. Bankr. P. 8013 was removed in the new Federal Rules of Bankruptcy Procedure, "logic sill compels the same conclusion with respect to the appellate powers of the District Court"). The standard of review for bankruptcy court decisions "is determined by the nature of the issues presented on appeal." *Baron & Budd, P.C. v. Unsecured Asbestos Claimants Comm.*, 321 B.R. 147, 157 (D.N.J. 2005). A bankruptcy court's factual findings are reviewed for clear error. *In re Smith*, 102 F.4th 643, 657 (3d Cir. 2024). Legal conclusions, in contrast, are subject to plenary review. *See In re Gilbert*, 120 F.4th 114, 121 (3d Cir. 2024) *amended* Nov. 1, 2024 ("We review without deference the Bankruptcy Court's legal analysis.").

Issues within the Bankruptcy Court's equitable discretion are reviewed for abuse of discretion. *In re Herhinger Inv. Co. of Del., Inc.*, No. 99-2261, 2001 WL 34368282, at *6 (D.N.J. Mar. 21, 2001) (citing *In re Cont'l Airlines*, 91 F.3d 553, 560 (3d Cir. 1996)). The decision to deny derivative standing is within the Bankruptcy Court's equitable powers. *See Cybergenics Corp. v. Chinery*, 330 F.3d 548, 568 (3d Cir. 2003). Accordingly, courts apply an abuse of discretion standard to decisions denying derivative standing. *See, e.g., In re Prosser*, 469 B.R. 228, 231 (D.V.I. 2012); *In re Racing Servs, Inc.*, 540 F.3d 892, 901 (8th Cir. 2008); *In re Adelphia Commc'ns. Corp.*, 371 B.R. 660, 665–66 (S.D.N.Y. 2007). "This standard is 'at root a deferential standard of review,' and the district court 'should not disturb an exercise of discretion unless there is a definite and firm conviction that the [bankruptcy] court . . . committed clear error of judgment in the conclusion it reached upon weighing the relevant factors.'" *In re Hudson's Coffee, Inc.*, No.

08-5133, 2009 WL 1795833, at *2 (D.N.J June 22, 2009) (quoting *In re Nutraquest, Inc.*, 434 F.3d 639, 645 (3d Cir. 2006)). As such, a bankruptcy court "abuses its discretion only if no reasonable person could take the view it adopted." *In re Cortuk*, No. 22-1690, 2022 WL 17361623, at *1 (D.N.J. Dec. 1, 2022) (quotation omitted).

III. <u>DISCUSSION</u>

On appeal, the Committee challenges the Bankruptcy Court's Standing Order and Confirmation Order. Preliminarily, however, Appellees argue that this appeal should be dismissed as equitably moot, which the Court addresses now first.

A. EQUITABLE MOOTNESS

Appellees argue that this appeal should be dismissed because it would be inequitable to undo any part of the confirmed Plan, which would have the effect of, *inter alia*, unraveling the bargained-for negotiations that were necessary for the confirmation. (*See* Invitae Opp. at 22–25; Deerfield Opp. at 20–24; U.S. Bank Opp. at 14–17.) The Committee suggests that the Plan itself would remain largely untouched, requiring only excision of the release provision at issue and the distribution of money damages. (Comm. Rep. at 4–5.) The Court agrees with the Committee; this appeal is not equitably moot.

Federal courts—including federal district courts sitting on appeal in bankruptcy matters—have a "'virtually unflagging obligation . . . to exercise the jurisdiction conferred on them." *In re Semcrude, L.P.*, 728 F.3d 314, 320 (3d Cir. 2013) (quoting *Colo. River Water Conservation Dist. v. United States*, 424 U.S. 808, 813 (1976)). However, under the prudential doctrine of equitable mootness, a court may forbear deciding a bankruptcy appeal "when [] the relief requested will undermine the finality and reliability of consummated plans of reorganization." *In re Tribune Media Co.*, 799 F.3d 272, 277 (3d Cir. 2015). At the Court's discretion, an appeal should be dismissed, "even if the court has jurisdiction and could fashion relief, if the implementation of that relief would be inequitable." *In re PWS Holding Corp.*, 228 F.3d 224, 235–36 (3d Cir. 2000) (citing *In re Cont'l Airlines*, 91 F.3d at 559). In other words, an appellate court may forgo meeting the merits of an appeal if the bankruptcy plan is too far down the path of reorganization.[5]

The Court of Appeals for the Third Circuit has described a two-prong inquiry to determine whether a case is equitably moot. *See In re Boy Scouts of Am.*, 137 F.4th 126, 160 (3d Cir. 2025). "First, we ask 'whether a confirmed plan has been substantially consummated.'" *Id.* (quoting *In re Semcrude*, 728 F.3d at 321). "Second, if it has, we consider 'whether granting the relief requested in the appeal will (a) fatally scramble the plan and/or (b) significantly harm third parties who have justifiably relied on plan confirmation.'" *Id.* (quoting *In re Semcrude*, 728 F.3d at 321). "The party seeking dismissal on equitable mootness grounds bears the heavy burden of proving its applicability 'based on an evidentiary record, . . . not speculation.'" *Id.* (quoting *In re Semcrude*, 728 F.3d at 321) (omissions in original).

1. Substantial Consummation

"Substantial consummation" is defined by the Bankruptcy Code itself and occurs upon: "(A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan." 11 U.S.C. § 1101(2). The Committee concedes that the Plan has been substantially consummated, and the first element is met. (Comm. Rep. at 4 ("While the Plan has been substantially consummated . . ."); *see also* Comm. Br. at 13 ("[t]he

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[5] To be clear, equitable mootness is distinct from constitutional mootness, and a determination that an appeal is equitably moot does not deprive a court of its subject matter jurisdiction. *See In re Anthanassious*, 418 F. App'x 91, 94 n.3 (3d Cir. 2011); *In re Tribune Media Co.*, 799 F.3d at 277 n.3.

Official Committee does not seek to unwind the distributions already made under the consummated plan").)[6]

2. Fatal Scrambling and/or Third Party Harm

"Once it is established that substantial consummation has occurred, the next step is to 'look to whether granting relief will require undoing the plan as opposed to modifying it in a manner that does not cause its collapse.'" *In re Exide Holdings, Inc.*, No. 20-11157, 2021 WL 3145612, at *6 (D. Del. July 26, 2021) (quoting *In re Semcrude*, 728 F.3d at 321). The inquiry here is whether the requested relief on appeal would either "fatally scramble the plan" or "significantly harm third parties who have justifiably relied on plan confirmation." *See In re Tribune Media Co.*, 799 F.3d at 278. The Court's "starting point" "is the relief an appellant specifically asks for." *Id.* However, "'a court may fashion whatever relief is practicable instead of declining review simply because full relief is not available.'" *Id.* (quoting *In re Blast Energy Servs., Inc.*, 593 F.3d 418, 425 (5th Cir. 2010)). Here, Appellees have not met the "heavy burden" of proving the applicability of the equitable mootness doctrine "'based on an evidentiary record'" because they have not shown that Appellant's successful appeal would either fatally scramble the plan or significantly harm any third parties. *See In re Boy Scouts of Am.*, 137 F.4th at 160 (quoting *In re Semcrude*, 728 F.3d at 321).

a. *Fatal Scrambling*

The Committee asserts that it simply seeks to "strike" the release from the Plan "without undoing other portions of that same plan." (Comm. Rep. at 4.) Later, the Committee adds that "all

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[6] Nonetheless, for the avoidance of doubt, the Court notes that each element has been satisfied: when the Plan was confirmed on August 7, 2024, the property was immediately transferred to the wind-down debtors, and a plan administrator took over the management of the property. (*See* Bankr. Plan at 25.) Since that time, hundreds of millions of dollars have been distributed to creditors. (*See, e.g.*, Bankr. ECF 1180 at 7 (representing that $299,742,331 has been paid out as of Q1 2025).) Accordingly, there is no question that the Plan has been substantially consummated.

of [its] claims may be addressed with money damages" and that "an appeal is not equitably moot when it merely seeks to redistribute cash distributed through the bankruptcy plan." (*Id.* at 5, 6.) Appellees argue that the requested relief is broader than striking one section of the Plan or redistributing money because, if Appellant were to be successful in their appeal, it would be permitted to commence protracted litigation against the Appellees and other Released Parties, seeking not only money damages or a redistribution, but the avoidance of a series of transactions that were entered into years ago, and which formed the basis of both the TSA and the Bankruptcy Plan. (*See* Deerfield Opp. at 21.)

In analyzing this prong of the equitable mootness test, the Court must "cautiously appl[y]" the doctrine, which is typically "only available in complex bankruptc[ies] where the reorganization involves intricate transactions." *See In re Boy Scouts of Am.*, 137 F.4th at 160 (cleaned up). The Bankruptcy Plan at issue in this case is not sufficiently complex to warrant the application of this "limited" doctrine. *See id.*

First, equitable mootness considerations typically apply in the context of reorganizations, not liquidations. *See In re New Century TRS Holdings, Inc.*, 407 B.R. 576, 587 & n.27 (D. Del. 2009); *see also In re Zenith Elec. Corp.*, 329 F.3d 338, 345 (3d Cir. 2003) (applying equitable mootness in the reorganization context); *In re Cont'l Airlines*, 91 F.3d at 560 (same); *In re Tribune Media Co.*, 799 F.3d at 277 (considering whether relief "will undermine the finality and reliability of consummated plans of *reorganization*" (emphasis added)). This makes sense because reorganization plans can involve the merging of one company into another or discharging the debts of a company so that it can continue to operate after the bankruptcy plan has concluded. By extension, "unraveling a substantially consummated *reorganization* plan can be difficult and inequitable—difficult in that it requires reversing multiple, often complex, future-looking transactions." *In re New Century TRS Holdings, Inc.*, 407 B.R. at 587 (emphasis added). Liquidations, on the other hand, are far simpler: they involve only the payment of funds to creditors. *Id.* at 590. Therefore, unwinding them is less difficult and less inequitable.

This appeal deals with a prototypical liquidation.[7] As Invitae's counsel argued at the confirmation hearing, "[i]n many ways, the plan is extraordinarily simple. We have three things to give, three buckets of consideration." (A8571, at 140:5–7.) The record supports this assertion. The Bankruptcy Plan here did not merge or separate multiple companies, involved no issuance of stock to new investors, and did not divide complicated assets between multiple entities. Instead, Invitae sold substantially all of its assets to one buyer, Labcorp (*see* Bankr. ECF No. 364), and then simply distributed the proceeds of the sale, plus any unsold property, to its creditors. (A1040.) Additionally, even though the Bankruptcy Plan paid out hundreds of millions of dollars in claims, those claims went to relatively few creditors. Indeed, in aggregate, there were only four 2028 Secured Notes Claims (one of which was Deerfield, holding 78% of the claims by dollar amount), 340 Convenience Class Claims, 50 Subsidiary Unsecured Claims, and 30 2028 Unsecured Claims. (A1044 n. 8.) The Convenience Class Claims, the largest by number of individual claimants, included a relatively small financial claim payout of just $9.2 million total. (A1046.) The Subsidiary Unsecured Claimants were owed even less, at $7.1 million total. (*Id.*) Therefore, the vast majority of the funds went to a single creditor—Deerfield—who is easily identifiable. Should the plan become un-confirmed, it would not be difficult to re-do the liquidation and payout the necessary claimants. *See In re New Century TRS Holdings, Inc.*, 407 B.R. at 590.

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[7] "Although the central purpose of Chapter 11 is to facilitate reorganizations rather than liquidations (covered generally by Chapter 7), Chapter 11 expressly contemplates liquidations." *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33, 37 n.2 (2008) (citing 11 U.S.C. § 1129(a)(11)).

By comparison, courts usually apply equitable mootness to appeals involving "complex bankruptcy reorganizations that include[] multiple related debtors, hundreds of millions of dollars in assets, liabilities and claims, and hundreds or thousands of creditors." *In re One2One Comm's, LLC*, 805 F.3d 428, 435 (3d Cir. 2015). The Third Circuit, in *In re One2One*, cited, as an example of a complex reorganization, *Continental*, which "involved the merger of fifty-three debtors with Continental, a $110 million investment in the reorganized debtor, the transfer by foreign governments of route authorities, and the assumption of leases and executory contracts worth over five billion dollars." *Id.* (citing *In re Cont'l Airlines*, 91 F.3d at 567). In another example, *Nordhoff*, "the reorganization plan required eighteen months of preparation between several parties, the exchange of over $100 million in bonds, the issuance of new stock, the extension of a sixty million dollar credit facility, and the exchange and cancellation of over $100 million of debt." *Id.* (citing *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F.3d 180, 182, 186 (3d Cir. 2001)). The liquidation at issue here is rather straightforward by comparison, requiring only a payout to a few hundred creditors, with the significant majority of the funds going to a single creditor. To undo the Plan at this point would not be an insurmountable task. *See In re Tribune Media Co.*, 799 F.3d at 283 ("It is true that some of the money has [already] been paid out, but it has gone to a readily identifiable set of creditors against whom disgorgement can be ordered.").

Accordingly, this appeal would not fatally scramble the Bankruptcy Plan, because it is a simple liquidation that could be easily undone.

b. Third Party Harm

Appellees have also not met their "heavy burden" to show that allowing an appeal will "significantly harm third parties who have justifiably relied on plan confirmation." *See In re Tribune Media Co.*, 799 F.3d at 278. Invitae names "two groups of third parties:" (1) "[d]ebtors' directors and officers"; and (2) Deerfield. (Invitae Opp. at 26.) Deerfield also lists the "Senior Secured Noteholders" (*i.e.*, the holders of the 2028 Secured Notes) and Convenience Class Creditors. (Deerfield Opp. at 23.) The equitable mootness analysis, however, "protects the interests of non-adverse third parties *who are not before the reviewing court* but who have acted in reliance upon the plan as implemented." *In re Abitibibowater, Inc.*, 490 B.R. 170, 173 (D. Del. 2013) (quoting *In re Cont'l Airlines*, 91 F.3d at 562) (emphasis added) (internal quotation marks omitted). Deerfield is currently before the Court, and therefore is not a "third party" for the present purposes.

As for the directors and officers, there is no indication that they acted in reliance of the Plan; they are not creditors and have no claims to the Debtor's estate as part of any class. They worked toward the consummation of the Plan in furtherance of their professional obligations and in consideration of a retention bonus, not a release in the Plan. (*See* A8442, at 11:12–14 (Q: "To be clear, nobody at the debtors promised you a release, right?" A: "Right." A: "And you are not aware of any agreement to which you owe a party that says you would get a release, right?" A: "Right.").) Directors and officers are not even the type of third party typically considered in an equitable mootness analysis. *See In re Nuverra Env't Sols., Inc.*, 834 F. App'x 729, 733 (3d Cir. 2021) ("The third-party analysis is particularly focused on equity investors, but can also include, to a lesser extent, lenders, customers, suppliers, and other creditors. The theme is that the third parties with interests protected by equitable mootness generally rely on the emergency of a reorganized entity from court supervision. (quotations omitted)).

Additionally, although the Convenience Class Creditors who were entitled disbursement under the Plan, might be *affected* if Appellant is successful and the Plan is unwound, Appellees have not shown that these creditors "acted in reliance upon the plan." *In re Abitibibowater, Inc.*, 490 B.R. at 173. These creditors were not party to the TSA, are not affected by the releases, and have done nothing but receive distributions—Appellees have not met their burden to show that any of these parties acted on the Plan "as implemented." *Id.*

The Senior Secured Noteholders are a closer call. Although, as explained above, Deerfield does not qualify as a "third party," Deerfield only possessed 78% of the Secured Notes; other creditors held the other 22%. (*See* A2946 ¶ 101; Proposed Compl. ¶¶ 15, 96.) U.S. Bank contends that these 22% of Secured Notes, worth over $60 million in outstanding principal, are publicly tradeable and may have been traded to any number of third parties in reliance on confirmation of the Plan. (U.S. Bank Opp. at 18–19.) On the effective date of the confirmed Plan, U.S. Bank states, "distributions were made through the Trustee to DTC [a clearinghouse] as sole record owner of the Secured Notes. From there, DTC would have made distributions to the next level of ownership until the funds ultimately reached the beneficial holders of the Secured Notes who held Secured Notes at that time." (*Id.* at 18.) Here, U.S. Bank cites to no record evidence, does not explain whether it would be possible (or why it would not be) to determine the current beneficial owners of the Secured Notes, and has not pointed to any "significant harm" to these Noteholders, other than the disgorgement of their payout. Accordingly, although there could conceivably be harm experienced by the 22% of unknown Senior Secured Noteholders, Appellees have not met their high burden to show how these creditors justifiably relied on the Plan or would be significantly harmed.

This appeal is not equitably moot. Although the parties concede that the Plan has been substantially consummated, deciding this appeal would neither fatally unscramble the Plan nor significantly harm third parties. The Court is mindful of the Third Circuit's charge that this doctrine must be "limited in scope" and wielded "with a scalpel rather than an axe." *See In re Boy Scouts* *of Am.*, 137 F.4th at 160. Accordingly, the Court exercises its discretion and declines to dismiss this appeal on this ground, proceeding instead to consideration of the merits of Appellant's case.

B. STANDING ORDER

The Committee first appeals the Standing Order. Appellant contests the Bankruptcy Court's overall analysis of its motion for derivative standing ("Standing Motion") as insufficient and asserts that some of the "hurdles" that the Bankruptcy Court relied on in its decision would not have negatively affected the putative litigation. (*See generally* Comm. Br. at 13–25.)

1. Legal Standard

Generally, the management of the debtor has a fiduciary duty to "maximize the value of the bankruptcy estate," which involves bringing avoidance actions against third parties. *See Cybergenics Corp.*, 330 F.3d at 573. By the terms of the Bankruptcy Code itself, this duty—and by extension, the ability to bring an avoidance action on behalf of the debtor—does not extend to other creditors. *See id.*; *see also In re Adelphia Commc'ns Corp.*, 544 F.3d 420, 423 (2d Cir. 2008) ("The Bankruptcy Code does not expressly authorize committees or individual creditors—in contrast to trustees and debtors-in-possession—to sue on behalf of an estate."). But "this situation immediately gives rise to the proverbial problem of the fox guarding the henhouse. If no trustee is appointed, the debtor—really, the debtor's management—bears a fiduciary duty to avoid fraudulent transfers that it itself made." *See Cybergenics Corp.*, 330 F.3d at 573. Indeed, "[d]ebtors sometimes lack the inclination, or the means, to bring actions that should be prosecuted." *In re Adelphia Commc'ns. Corp.*, 330 B.R. at 373.

This is where derivative standing comes in, providing a "critical safeguard against lax pursuit of avoidance actions." *Cybergenics*, 330 F.3d at 573. As a result, "bankruptcy courts can confer derivative standing upon creditors' committees to bring actions to recover property for the benefit of the estate." *In re Centaur, LLC*, No. 10-10799, 2010 WL 4624910, at *4 (Bankr. D. Del. Nov. 5, 2010) (citing *Cybergenics*, 330 F.3d at 548). However, the decision to grant derivative standing is "uncommon" and "'the exception rather than the rule.'" *In re DeCurtis Holdings, LLC*, No. 23-10548, 2023 WL 5274925, at *4 & n.43 (Bankr. D. Del. Aug. 14, 2023) (quoting *In re Merritt*, 711 F. App'x 83, 86 (3d Cir. 2017) and citing *In re Airocare, Inc.*, No. 10-14519, 2011 WL 2133526, at *1 (Bankr. E.D. Va. May 24, 2011) ("The Bankruptcy Code does not expressly permit such parties to initiate adversary proceedings. Derivative standing is thus an implicit exception to the 'general rule' whereby the Bankruptcy Code assigns to the trustee or debtor-in-possession 'the privilege of prosecuting' various actions on behalf of the estate.")). The party seeking standing bears the burden of proof. *In re Diocese of Camden, N.J.*, No. 20-21257, 2022 WL 884242, at *4 (Bankr. D.N.J. Mar. 24, 2022); *In re MRPC Christiana, LLC*, 18-26567, 2019 WL 6652237, at *10 (Bankr. D.N.J. Dec. 5, 2019) ("It is the creditor's burden in the first instance to demonstrate it satisfies the[] prerequisites for derivative standing.").

In determining whether to grant a creditor committee derivative standing, courts examine, *first*, whether the committee has "present[ed] a colorable claim or claims for relief that on appropriate proof would support a recovery," and *second*, whether the debtor "unjustifiably failed to bring suit." *In re STN Enterprises*, 779 F.2d 901, 905 (2d Cir. 1985).[8] The second element is a cost-benefit analysis and requires the court to "assure itself that there is a sufficient likelihood of success to justify the anticipated delay and expense to the bankruptcy estate that the initiation and continuation of litigation will likely produce." *Id.* at 906; *see also In re Diocese of Camden, N.J.*, 2022 WL 884242, at *9 ("It is appropriate to perform a cost-benefit analysis."). Indeed, "even if

[8] The parties agree that the *STN* test is the appropriate one to apply here. (*See* Comm. Br. at 15; Invitae Opp. at 27; Deerfield Opp. at 25.) This test has been applied by the Bankruptcy Court before. *See, e.g.*, *In re One2One Commc'ns, LLC*, No 12-27311, 2014 WL 3882467, at *3 (Bankr. D.N.J. Aug. 7, 2014).

the proposed actions represent colorable and beneficial claims against the [estate], the [d]ebtor might well be justified in declining to bring them if a claim was colorable but seemed unlikely to result in a favorable resolution. Likewise, the [d]ebtor might be justified in declining to bring a claim that was likely to achieve a favorable resolution but not one favorable enough to justify the time and expense of litigation and a concomitant delay in plan confirmation." *In re Roman Catholic Diocese of Harrisburg*, 640 B.R. 59, 85 (Bankr. M.D. Pa. 2022). The cost–benefit analysis is meant to guard against allowing standing "without any assurance that doing so would likely lead to a net recovery for the estate." *In re Diocese of Camden, N.J.*, 2022 WL 884242, at *9.

Under *STN*, a court's inquiry involves a determination of: (1) "whether [the] action asserting such claim(s) is likely to benefit the reorganization estate"; (2) "the probabilities of legal success in the event the action is pursued"; (3) "financial recovery in event of success"; (4) "whether appointment of a trustee or another party to bring the action would be preferable;" and (5) "the cost to the estate in proceeding with the action and the terms relative to any attorneys' fees." *STN*, 779 F.2d at 905–06. These factors are "by no means exhaustive." *In re One2One Commc'ns, LLC*, No. 12-27311, 2014 WL 3882467, at *3 (Bankr. D.N.J. Aug. 7, 2014) (quoting *In re Racing Servs.*, 540 F.3d at 901).

2. Analysis

On May 22, 2024, the Committee filed a Standing Motion to commence a lawsuit aimed at unwinding the March and August Exchanges. (Bankr. ECF 792; A0857–A0931, "Standing Mot.") A 72-paged, 272-paragraphed, fourteen-count proposed Adversary Complaint (the "Proposed Complaint") was appended to the Motion. (Bankr. ECF 792-1; A0933–A1009, "Proposed Compl.") Through the Standing Motion, the Committee sought to "bring[] a series of estate claims and causes of action . . . to remedy conduct by which the Company's officers and directors gave one group of unsecured creditors all of the equity value of the Company's assets and attempted to leave more than $1 billion of similarly situated unsecured creditors with nothing." (Proposed Compl. ¶ 1.)

After the Committee filed the Standing Motion and Proposed Complaint, that summer, the parties filed voluminous briefing. (Bankr. ECF Nos. 713, 720, 728, 752.) On July 9, Judge Kaplan held a six-hour hearing on the Standing Motion where he heard testimony from four witnesses, as well as closing statements. (*See* Bankr. ECF No. 785.) On July 12, Judge Kaplan issued a preliminary bench ruling denying the Standing Motion. (Bankr. ECF No. 793; A7972–A8019, "Standing Hearing," at 8:20–9:1.)

Judge Kaplan noted that a bankruptcy court can only grant derivative standing "when a movant has established that there is a colorable claim which exists *and* that the debtor has unjustifiably refused to bring such a claim." (*Id.* at 5:10–12 (emphasis added).) "The bottom line inquiry," Judge Kaplan explained, "is whether asserting such claims is likely to benefit to the estate." (*Id.* at 5:13–14.) Judge Kaplan listed a variety of factors that a bankruptcy court "can and should take into account" when examining a debtor's decision to pursue litigation, including "the probability of success, anticipated financial recovery for creditors, and the cost and the risks and the delays to the administration of the bankruptcy estate." (*Id.* at 5:17–19.) This is a cost-benefit analysis "employed to determine whether the debtors' decisions or actions are justifiable." (*Id.* at 5:22–23.)

Judge Kaplan said that in undertaking the cost-benefit analysis, he took into account "a variety of significant issues and hurdles" related to the litigation. (*Id.* at 6:13.) Judge Kaplan listed a number of different hurdles, each of which "would need to be addressed as part of the litigation in order to be successful going forward." (*Id.* at 8:15–17.) The hurdles were:

1. "The potential availability of safe-harbor defenses under 546(e)";
2. "The potential availability of exculpation and indemnification rights under both Delaware law and the corporate charter and other corporate governance documents";
3. "The significant factual dispute as to whether the debtor was insolvent at the time of the relevant transactions as opposed to a hindsight analysis or consideration of subsequent events";
4. "Meaningful factual disputes as to the equivalency of the value received by the debtor from the transactions in question";
5. "The potential risks and costs to the estate in jettisoning a confirmable plan supported by significant stakeholders and potentially resulting in significant delays and distributions";
6. "The potential risks and administrative costs and delays associated with pursuing substantive litigation";
7. "The substantial size of the unsecured creditor body, taking into account the significant investment by Deerfield as well [as] relative to any possible recovery";
8. "The arm's-length nature of the negotiations pre-petition with multiple parties going back to the Spring of '22";
9. "The use of professional advisors, special Committees, and independent directors in assisting and advising the board in the exercise as well as the [Directors & Officers] in their collective exercise of their business judgment";
10. "The high threshold for overcoming [Director & Officer] business judgment decisions";
11. "The lack of any asserted breach in the underlying financial instruments and documentation"; and
12. "In general, Deerfield's lack of control over the debtor corporation or its status—lack of status as an insider."

(*Id.* at 6:15–7:20; 8:6–8:11 (numeration added).)

All parties to this appeal spill considerable ink on the underlying merits of the Committee's Standing Motion, rehashing legal arguments related to colorability, various safe harbors, hotly-contested factual discrepancies, and a variety of other issues. Here, Judge Kaplan's decision to deny the Standing Motion cited to a myriad of factors consistent with those enumerated in *STN*. For example, as to the first factor, "whether the action is likely to benefit the reorganization estate," *see In re G-I Holdings, Inc.*, No. 04-3423, 2006 WL 1751793, at *11 (D.N.J. June 21, 2006), the

Bankruptcy Court identified that the Plan had already been supported by a number of significant stakeholders, and that to engage in litigation at this point would result in significant delays. (Standing Hearing at 6:24–7:2.) As to the second factor, the "probabilities of legal success in the event the action is pursued," *see In re G-I Holdings, Inc.*, 2006 WL 1751793, at *11, the Bankruptcy Court mentioned the Proposed Complaint's legal deficiencies including: (1) the availability of safe harbor defenses, (2) the availability of exculpation and indemnification rights, (3) the "high threshold for overcoming D&O business judgment decisions;" (4) and the "lack of any asserted breach in the underlying financial instruments and documentation" (*see* Standing Hearing at 6:15–19, 8:6–9), and factual disputes, such as whether the Debtor was insolvent at the time of the relevant transactions, and whether the Debtor received equivalent value in the transactions in question—both central to a claim for fraudulent transfer, *see* 11 U.S.C. § 548(a)(1)(B). (Standing Hearing at 6:19–23.)

However, despite the litany of factors set forth that counseled against this "uncommon" remedy, *In re DeCurtis Holdings, LLC*, 2023 WL 5274925, at *4 & n.43, Judge Kaplan repeatedly reserved the right to supplement the record, but never did so. In rendering his findings, the Bankruptcy Court noted no fewer than five times that the ruling was "preliminary." (*See, e.g.*, Standing Hearing 4:8–9; 4:11–13; 4:14–16; 9:2–8; 10:10.)

While it is clear that Judge Kaplan appropriately considered a myriad of factors which informed his preliminary ruling, this Court believes that the record would benefit from a more fulsome explication and analysis. *See G-I Holdings, Inc.*, 2006 WL 1751793, at *11–12 ("A cost-benefit analysis may very well have been done by the bankruptcy [c]ourt, but it was not done explicitly." (cleaned up)). The Court, sitting on appeal and guided by the Third Circuit's practice, will issue a "limited record remand solely for purposes of supplementing the incomplete record."

Virgin Islands Soc'y, Inc. v. Virgin Islands Bd. of Land Use Appeals Golden Resorts LLP, 10 F.4th 221, 235–36 (3d Cir. 2021); *In re Lipitor Antitrust Litig.*, 855 F. 3d 126, 151–52 (3d Cir. 2017), *as* amended (Apr. 19, 2017) ("It is a common practice among the Courts of Appeals to retain jurisdiction over an appeal while making a limited remand for additional findings or explanations."). In the meantime, this Court will retain jurisdiction over the consolidated appeal.

Accordingly, the Bankruptcy Court's decision to deny the Standing Motion is **REMANDED** for the Bankruptcy Court to supplement its factual findings and analysis, consistent with this Opinion.

C. Debtor Releases

The Committee appeals the Bankruptcy Court's confirmation of the Plan, specifically as to the Debtor Releases embedded in Article VIII of the Plan. (*See* A8916–A8920.) The Plan releases any claims by the Debtor against a series of Released Parties, including, *inter alia*, Deerfield, U.S. Bank, each party's current and former directors, managers, officers, employees, attorneys, accountants, consultants, and other Related Parties. (*See* A8885.) The problem for the Committee is that such a release insulates from liability any defendant against whom the Committee might have sought to bring a derivative complaint.

The Bankruptcy Code permits a bankruptcy plan to provide for "the settlement or adjustment of any claim or interest belonging to the debtor or to the estate." 11 U.S.C. § 1123(b)(3)(A); *see also In re Exide Holdings, Inc.*, 2021 WL 3145612, at *13 (affirming the availability of Section 1123(b)(3)(A) releases in Chapter 11 liquidations). But this permission is not limitless. When confirming a plan with such a settlement or compromise, "the court has the duty 'to determine that a proposed compromise forming part of a reorganization plan is fair and equitable.'" *In re Coram Healthcare Corp.*, 315 B.R. 321, 334 (Bankr. D. Del. 2004) (quoting

Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968)). Where, as here, releases are granted to non-debtors, "additional factors are often relevant to determine the fairness of the compromise." *Id.* (citing *In re Cont'l Airlines*, 203 F.3d 203, 212–14 (3d Cir. 2000)). Courts in this circuit consider the five factors applied in *In re Zenith Electrics Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999):

> (1) an identity of interest between the debtor and non-debtor such that a suit against the non-debtor will deplete the estate's resources;
> (2) a substantial contribution to the plan by the non-debtor;
> (3) the necessity of the release to the reorganization;
> (4) the overwhelming acceptance of the plan and release by creditors and interest holders; and
> (5) the payment of all or substantially all of the creditors and interest holders under the plan.

In re One2One Commc'ns, LLC, No. 13-1675, 2016 WL 3398580, at *6 (D.N.J. June 14, 2016) (citing *Zenith*, 241 B.R. at 110 and *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 937 (Bankr. W.D. Mo. 1994)).[9] "These factors are neither exclusive nor conjunctive requirements, but simply provide guidance in the [c]ourt's determination of fairness." *In re Washington Mutual, Inc.*, 442 B.R. 314, 346 (Bankr. D. Del. 2011).[10] "Two elements are almost universally determinative": *first*, that the "success of the debtors' reorganization bears a relationship to the release of the non-consensual parties," and *second*, that the releasees "have provided a critical financial contribution to the debtors' plan that is necessary to make the plan feasible in exchange for receiving a release of liability." *See In re 710 Long Ridge Road Operating Co., II, LLC*, No. 13-13653, 2014 WL 886433, at *14 (Bankr. D.N.J. Mar. 5, 2014).

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[9] The Court refers to these factors as the *Master Mortgage* factors, as the parties do in their briefing. *See In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 937 (Bankr. W.D. Mo. 1994).

[10] All parties to this appeal agree that the *Master Mortgage* factors are applicable to the debtor releases at issue. (*See* Comm. Br. at 24; Invitae Opp. at 48; Deerfield Op. at 51–52; Comm. Rep. at 24.)

As set forth above with the Standing Order, this Court finds the Bankruptcy Court's findings relating to the Debtor Releases would benefit from additional analysis and will therefore issue a limited remand. (*See supra* at 20–21); *Virgin Islands Soc'y, Inc.*, 10 F.4th at 235–36. Accordingly, the Court agrees with the Committee that "the Debtor releases of Estate claims in the Confirmation Order should [] be remanded for further factual findings and legal conclusions required to meet existing precedent." (Comm. Br. at 32.); *In re One2One Communications, LLC*, 2016 WL 3398580, at *6 (district court remanding the issue of releases in a confirmed plan to the bankruptcy court citing insufficient analysis of the *Master Mortgage* factors). In the meantime, this Court will retain jurisdiction over the consolidated appeal.

CONCLUSION

For the foregoing reasons, the Court finds that this appeal is not equitably moot, and further **REMANDS** the Bankruptcy Court's decision to deny the Standing Motion and **REMANDS** the confirmation of the Debtor Releases contained in Article VIII of the Plan for the limited purpose of further analysis consistent with this Opinion. An appropriate Order accompanies this Opinion.

ROBERT KIRSCH
UNITED STATES DISTRICT JUDGE

Dated: June 25, 2025