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Introduction

Generally, when a debtor files for protection under chapter 11 of the United States Bankruptcy Code (the "Bankruptcy Code"), a plan of reorganization is filed at some point with the bankruptcy court.[1] The court then holds a hearing to determine whether the judge will confirm the reorganization plan.[2] The judge will confirm the plan if it meets the criteria of Section 1129 of the Bankruptcy Code, which requires, among other things, that any payments made in connection with the plan are reasonable.[3] A plan of reorganization is a significant component of a debtor's emergence from bankruptcy, as it affects the rights of the debtor and its creditors by binding both debtors and creditors to the provisions of the plan, whether or not all of the creditors have accepted the plan.[4]

In *In re Relativity Fashion, LLC*, the United States Bankruptcy Court for the Southern District of New York held that Netflix was not permitted to stream certain films before they were

[1] 11 U.S.C. § 1121 (2012).
[2] 11 U.S.C. § 1128 (2012).
[3] 11 U.S.C. § 1129 (2012).
[4] 11 U.S.C. § 1141 (2012).

theatrically released because the debtors' confirmed reorganization plan contemplated the theatrical release of the movies prior to Netflix's streaming.[5] The debtors' anticipated release of the films yielded specific financial projections and was a critical factor in the court's determination that the plan was feasible as required by the Bankruptcy Code.[6] The court concluded that the provisions of the confirmed reorganization plan were binding on the debtors and creditors, restraining Netflix from releasing the films.[7]

This holding illustrates the notion that a court will generally enforce reorganization plans that have been previously confirmed absent an extreme circumstance.[8] What process does the court use to determine whether debtors and creditors are bound to a reorganization plan? This memorandum will examine this question by considering two main inquiries that courts explore before deciding whether the parties must abide by a plan's provisions. Part I analyzes the doctrine of res judicata and its application to the validity of subsequent actions that challenge a reorganization plan. Part II examines the effect of an independent judgment on the effectiveness and enforceability of a reorganization plan.

I. Res Judicata May Bar Subsequent Challenges to a Confirmed Reorganization Plan

The doctrine of res judicata provides that parties are barred from re-litigating issues that were previously decided by a court of competent jurisdiction.[9] The central purpose of res judicata is to relieve parties of the cost and aggravation of numerous lawsuits and to encourage reliance on final judgments.[10] The bankruptcy court considers four elements in determining

[5] *In re Relativity Fashion, LLC*, No. 15-11989, 2016 WL 3212493, at *12 (S.D.N.Y. June 1, 2016).
[6] *Id.* at *3.
[7] *Id.* at *9.
[8] *Id.* at *10.
[9] *In re Arcapita Bank B.S.C.*, 520 B.R. 15, 21 (Bankr. S.D.N.Y. 2014).
[10] *Allen v. McCurry*, 449 U.S. 90, 94 (1980).

whether res judicata bars subsequent actions between the parties after the issuance of a confirmed reorganization plan: (1) whether the prior decision was a final judgment on the merits; (2) whether the litigants were the same parties; (3) whether the prior court was of competent jurisdiction; and (4) whether the causes of action were the same.[11] It is well settled that a bankruptcy judge's order confirming a reorganization plan is a final judgment on the merits.[12] The same parties to an action include those who control an action although not a formal party, and those whose interests are represented by a party to the action.[13] Further, the district courts have original and exclusive jurisdiction of all cases under Title 11.[14] To determine whether the two causes of action are the same, the court assesses whether the same evidence, transaction, and factual issues are present in the cases.[15]

In *Corbett*, the chapter 11 debtor incurred withdrawal liability to a pension fund after laying off its employees.[16] The confirmed plan of reorganization included the debtor's parent company by providing that the plan's confirmation would discharge claims against the debtor's affiliates.[17] Subsequently, trustees of the pension fund sued the parent company to collect the withdrawal liability.[18] The court held that res judicata barred the trustees from challenging the reorganization plan, limiting the debtor's obligation to the undertakings agreed to in the confirmed plan.[19] The judge found that the court's confirmation of the reorganization plan resulted in a final judgment on the merits, the litigants in both cases were the same parties, and

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[11] *Corbett v. MacDonald Moving Serv., Inc.*, 124 F.3d 82, 88 (2d Cir. 1997).
[12] *CoreStates Bank, N.A. v. Huls Am., Inc.*, 176 F.3d 187, 205 (3d Cir. 1999).
[13] *In re Frank's Nursery & Crafts, Inc.*, No. 04-15826, 2006 WL 2385418, at *5 (S.D.N.Y. May 8, 2006).
[14] 28 U.S.C. §1334 (2012).
[15] *Sure-Snap Corp. v. State St. Bank & Tr. Co.*, 948 F.2d 869, 874 (2d Cir. 1991).
[16] *Corbett*, 124 F.3d at 84.
[17] *Id.*
[18] *Id.*
[19] *Id.*

the bankruptcy court was a court of competent jurisdiction.[20] The two causes of action were deemed the same because they involved the same transaction, evidence, and factual issues.[21] The transaction in both claims was the payment of the debtor's withdrawal liability, the actuarial valuations and financial proof were evidence needed in both cases, and the factual issues were the same.[22] Therefore, all elements required for res judicata to bar a subsequent action were present.[23]

Moreover, res judicata applies to final judgments which overrule objections to a reorganization plan, and to all issues that could have been decided at the confirmation hearing.[24] Claims which could have been brought in a prior proceeding, and which may have affected the provisions of a bankruptcy repayment schedule, cannot be litigated thereafter.[25]

In contrast, res judicata is inapplicable if a cause of action is reserved for later judgment.[26] Further, res judicata will not bar a subsequent action if the current litigants are different from the previous litigants, nor if the current litigants lack privity with a previous

[20] *Id.* at 88-9.
[21] *Id.*
[22] *Id.* at 90
[23] *Id.* at 92.
[24] *See CoreStates*, 176 F.3d at 194 (holding that a bank's claims were precluded because it could have pursued its claim as an ancillary claim to the confirmation proceeding, but elected not to); *see also Arcapita*, 520 B.R. (holding that a bank was barred from attacking the debtor's confirmed plan because it could have raised its issues before or during the confirmation process, but waited to bring a subsequent action).
[25] *Sure-Snap*, 948 F.2d at 870.
[26] *Arcapita*, 520 B.R. at 21.

party.[27] However, literal privity is not necessary for res judicata to apply, as a party will be bound by a previous judgment if its interests were adequately represented in a former suit.[28]

II. Judgment in a Subsequent Proceeding is Not Permitted if it Renders the Reorganization Plan Ineffective or Unenforceable

In addition to determining whether the doctrine of res judicata applies, bankruptcy courts can examine whether an independent judgment in a successive proceeding that challenges provisions of a confirmed plan would impair or destroy the enforceability or effectiveness of the plan.[29]

For example, in *Sure-Snap*, despite confirmation of the debtor's reorganization plan, the debtor brought tortious conduct claims against its creditors.[30] Sure-Snap Corporation had entered into loan agreements with several banks, however, Sure-Snap subsequently filed for bankruptcy and generated a repayment plan.[31] Sure-Snap later brought lender liability claims against the banks, arguing that these claims were distinguishable from the financial claims asserted in the bankruptcy proceeding.[32] The basis of Sure-Snap's tort liability claim was the bank's decision to terminate Sure-Snap's loan, despite the fact that Sure-Snap was not in default of any payments.[33] However, when Sure-Snap filed for bankruptcy and submitted its plan for reorganization to the court, its disclosure statement made no mention of any counterclaims or

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[27] *See United States v. Envicon Dev. Corp.*, 153 F. Supp. 114, 124 (D. Conn. 2001) (holding that res judicata did not bar the Department of Housing and Urban Development from bringing suit against a property manager when the parties were not in privity to each other because their interests differed completely in the prior suit).
[28] *Monahan v. N.Y. City Dep't of Corr.*, 214 F.3d 275, 285 (2d Cir. 2000).
[29] *Sure-Snap*, 948 F.2d at 873.
[30] *Id.* at 870.
[31] *Id.*
[32] *Id.*
[33] *Id.* at 871.

defenses against the banks.[34] The plan of reorganization provided for Sure-Snap to transfer its plant to the banks to satisfy the banks' claims.[35] After the court confirmed this plan, Sure-Snap pursued claims against the banks.[36] The court held that the confirmed plan precluded Sure-Snap from subsequently suing the banks because Sure-Snap's failure to raise these claims during the prior bankruptcy proceeding would affect the confirmed reorganization plan.[37] The judge found that if the court had found merit in Sure-Snap's tort claims, it likely would have arranged a different plan and schedule to dispose of Sure-Snap's assets.[38] A judgment in the subsequent proceeding would have impaired enforcement of the confirmed plan of reorganization; therefore, the court barred the debtor's subsequent suit against the banks.[39]

Similarly, the *Corbett* court held that trustees of the debtor's withdrawal liability fund were not permitted to challenge the terms of the debtor's confirmed plan because a decision in the trustees' favor would render the debtor's confirmed plan unenforceable.[40] There, the plan of reorganization provided for the debtor's parent company to distribute funds to pay the withdrawal liability that was incurred as a result of the debtor terminating its employees, and for its excess cash flow to be paid to the debtor's unsecured creditors.[41] Prior to the plan's confirmation, the amount of the withdrawal liability was recalculated and found to be greater than the original calculation, however, an amended proof of claim was never filed.[42] The

[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.* at 876
[38] *Id.*
[39] *Id.*
[40] *Corbett*, 124 F.3d at 92.
[41] *Id.* at 91.
[42] *Id.* at 84.

trustees of the fund sued the debtor's parent company to collect the recalculated amount.[43] However, because the plan provided for the parent company's excess cash flow to be paid to the debtor's unsecured creditors, the parent company could not be extricated from the plan without prejudicing the rights of the unsecured creditors.[44] Therefore, the trustees bringing suit against the parent company for a recalculated amount of liability debt would have destroyed enforceability of the reorganization plan.[45]

Likewise, the *Relativity* court found that a judgment in Netflix's favor in its subsequent action against the debtor would impair the feasibility of the debtor's confirmed plan of reorganization.[46] The plan provided for specific financial projections based on the ability to release certain films in theaters prior to Netflix streaming the movies.[47] The plan contained certain theatrical release dates for the films on the assumption that the debtor had the legal right to exploit the films in the manner specified according to its financial projections.[48] The court held that the debtors' ability to release the films first, as indicated in the reorganization plan, was key to feasibility of the plan.[49] Therefore, Netflix was enjoined from challenging the debtors' confirmed reorganization plan.[50]

Conclusion

Provisions of a debtor's plan of reorganization may have a colossal impact on subsequent suits that a debtor or creditor may attempt to pursue. The cases mentioned above illustrate the finality of judgments in bankruptcy cases. A bankruptcy judge can explore an independent

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[43] *Id.*
[44] *Id.* at 92.
[45] *Id.*
[46] *Relativity*, 2016 WL 3212493, at *5.
[47] *Id.* at *2.
[48] *Id.*
[49] *Id.* at *3
[50] *Id.* at *17.

judgment's effect on the reorganization plan and will examine possible res judicata effects of prior suits if requested by an affected party. A confirmed plan of reorganization involves a final judgment on the merits, and many times, it will completely bar subsequent actions by a debtor or creditor. Bankruptcy courts will enforce confirmed plans of reorganization absent an extreme situation, and will prohibit actions that compromise the validity and enforceability of these plans.