CARLTON FIELDS

Bar Orders Must Be Integral To Settlement in Order To Be Essential

August 31, 2020

Bar orders have been a useful tool in resolving various types of litigation. These include claims against companies that are in bankruptcy or receivership.

The Eleventh Circuit recently held in a published decision—*Sec. & Exch. Comm'n v. Quiros*, 966 F.3d 1195 (11th Cir. 2020)—that bar orders entered in connection with a settlement must be "integral to the settlement" in order to be deemed "essential" upon a challenge.

Parties involved in disputes where a bar order is being considered as part of the resolution should take particular note of this decision, especially for cases in Georgia, Florida, and Alabama.

Background

In 2016, the Securities and Exchange Commission (SEC) filed a civil enforcement action against an individual and certain corporations that he controlled, alleging that the individual engaged in securities fraud. Faced with several other lawsuits following the SEC action, the individual hired two law firms as counsel (the "Law Firms") despite his assets being frozen by the district court in the SEC action.

The Law Firms nonetheless needed to be paid so, following a coverage dispute, the individual's insurer and the Law Firms entered into an Interim Funding Agreement under which the insurer agreed to advance defense costs up to $1 million, as long as the advances were repaid if the defense was not found to be covered in the coverage action. Further, the Interim Funding Agreement made the individual personally responsible to repay any legal fees, not the Law Firms.

The $1 million advance under the Interim Funding Agreement was quickly used up in defense costs, but before the Law Firms could even file invoices under the Interim Funding Agreement, the

individual fired them. Further, the asset-freeze order from the SEC action prevented the individual from using insurance to pay his counsel. The Law Firms attempted to intervene in the SEC action but were denied. The district court instead modified the asset-freeze order to permit the Law Firms to sue the insurer in New York state court seeking the $1 million under the Interim Funding Agreement—the case is now pending.

The Settlement

Sometime later, the receiver, the insurer, and the individual (the "Appellees") settled the coverage issues in connection with the SEC action wherein it was agreed: (i) the insurer would pay $1.4 million to resolve the coverage action; and (ii) the insurer would issue a $500,000 final payment if the district court entered an order barring related claims, including the Law Firms' Interim Funding Agreement lawsuit in New York. Over the Law Firms' objection, the district court entered the order (the "Bar Order") finding it was essential to the settlement. The Law Firms appealed to the Eleventh Circuit Court of Appeals for review of the district court's entry of the Bar Order for abuse of discretion.[1]

The Meaning of "Essential" Under *In re Seaside*

In analyzing the Bar Order in this case, the court reaffirmed that bar orders are an extraordinary remedy that should only be entered "cautiously and infrequently and only where essential, fair, and equitable."[2] This standard from *In re Seaside* elicits a two-part inquiry: (1) a court must conclude that the bar order is essential; and (2) a court must decide that the bar order is fair and equitable, with an eye toward its effect on barred parties.[3] At the heart of this appeal is the first part of the inquiry—whether the Bar Order was "essential."

Since the Eleventh Circuit had not previously specifically addressed what makes a bar order "essential," it looked for the answer among bar order cases in the bankruptcy context. The court looked at *In re Munford* in holding that a bar order is essential when it is "integral to settlement."[4] In *In re Munford*, the court found that a bar order was appropriate because "[b]ut for the bankruptcy court's bar order," the parties "would not have entered into the settlement agreement."[5]

The Eleventh Circuit favorably cited several opinions from bankruptcy and district court judges finding that bar orders must be "essential" to resolving the settling parties' dispute.[6] The court noted that public policy supports this essentiality requirement because, while such orders can also bar a third party's claim even if the third party may not be part of the relevant lawsuit or settlement, bar orders play a key role in facilitating settlement and in turn saving court, parties', and taxpayer resources.[7] Therefore, the policy behind settlement bar orders supports their use only when needed to halt the parties' litigation. While the court previously affirmed a bar order in *In re U.S. Oil & Gas* that the parties deemed non-essential to their resolution, the appellants did not raise essentiality in

their appeal and that opinion was issued before "essentiality" became a cemented element in *In re Munford*.[8]

Bar Order Not Essential to the Settlement Due to Term in Agreement

Going forward, as to essentiality of a settlement bar order, the court stated, "[i]f the parties would have still resolved their dispute without entry of the bar order, the order is not essential and the court should not enter it."[9] In the instant case, a recital in the settlement agreement stated that the "settlement is contingent on the District Court approving this Agreement and **that the parties shall seek the issuance of a bar order**."[10] The settlement did not turn on the actual issuance of a bar order, but rather, the parties' **seeking** a bar order.

The actual issuance of the Bar Order under the settlement provided for an incentive "final payment" of $500,000 from the insurer, but the settlement of the parties' litigation is nonetheless fully effective without the Bar Order. The nail in the coffin that the Bar Order was not integral to the settlement was a provision in the settlement explicitly stating that the insurer will pay $1.4 million "regardless of whether a bar order, if one is issued, becomes final and non-appealable."[11] The court also cited to the transcript of the bar order hearing where the insurer counsel did not argue the essentiality of the Bar Order to the settlement. On these bases, the court found the district made a clear error of judgment in finding that the bar order was essential the settlement and vacated it.

So What Should Lawyers, Insurers, and Companies That Need Bar Orders Do?

The recent *Quiros* opinion provides useful guidelines on how to ensure that a settlement bar order is deemed "essential" to a settlement—without the bar order, there must be no settlement. If a settlement can survive without the issuance of a bar order, such bar order is not integral to the settlement and is therefore not essential. To ensure a bar order is found essential to a settlement, parties can include explicit language in the agreement, or plan of reorganization in the bankruptcy context, stating that the issuance of a bar order is an integral part of the settlement or plan and is essential to its implementation. Parties should make clear that mere efforts to obtain a bar order are insufficient under such settlement or plan.

[1]The court reviews a district court's entry of a settlement bar order for abuse of discretion. *In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 491 (11th Cir. 1992).

[2]*In re Seaside Eng'g & Surveying, Inc.*, 780 F.3d 1070, 1079 (11th Cir. 2015).

[3]The Court also cited *In re Munford, Inc.*, 97 F.3d 449, 455 (11th Cir. 1996) as support for the bifurcated approach to affirming bar orders.

[4] *In re Munford, Inc.*, 97 F.3d at 455.

[5] *Id.*; the Court also noted that, in the bankruptcy/restructuring context, bar orders should only be issued in "unusual cases in which such an order is necessary for the success of the reorganization." *In re Seaside*, 780 F.3d at 1078.

[6] *See In re Jiangbo Pharm., Inc.*, 520 B.R. 316, 323 (Bankr. S.D. Fla. 2014) ("The evidence before the Court shows that the Bar Order is an integral part of the Amended Settlement without which it would not be consummated."), *aff'd sub nom. Brophy v. Salkin*, 550 B.R. 595 (S.D. Fla. 2015); *In re Rothstein Rosenfeldt Adler, P.A.*, No. 09-34791-BKC-RBR, 2010 WL 3743885, at *6 (Bankr. S.D. Fla. 2010) (finding that a bar order was essential because the settlement allowed the parties to terminate their agreement without the bar order and because the trustee "testified that without a bar order, the Settling Parties would not have had entered into the Settlement"); *In re Sentinel Funds, Inc.*, 380 B.R. 902, 905 (Bankr. S.D. Fla. 2008) (holding that a bar order was "not integral to the settlement" because the settlement did not rise or fall on the bar order and instead required the trustee only to "use his best efforts to obtain [the bar order]").

[7] *In re U.S. Oil & Gas*, 967 F.2d at 493-4.

[8] *Id.* at 494-96; *In re Munford*, 97 F.3d at 455.

[9] *Quiros*, 966 F.3d at 1200.

[10] *Id.*

[11] Settlement Agreement, S.D. Fla. Case No. 1:16-cv-21301-DPG, Doc. No. 523-1, at 4.

Authored By

Luigi Orengo Jr.

Aaron S. Weiss

Related Practices

Appellate & Trial Support
Creditors' Rights and Bankruptcy
Litigation and Trials