

Chapter 11 Plan Third-Party Release Provisions: Structuring or Objecting to NonDebtor Releases

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CHAPTER 11 PLAN THIRD-PARTY RELEASE PROVISIONS: STRUCTURING OR OBJECTING TO NONDEBTOR RELEASES

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Agenda

- I. Court standards for approving third-party releases
- II. Requirements for adequate disclosure of third-party releases
- III. Recent case law developments: explicit vs. implicit consent
- IV. Structuring non-debtor release
- V. Analyzing and objecting to non-debtor releases

Chapter 11 Plan Third-Party Release Provisions

Structuring or Objecting to Non-Debtor Releases

Court Standards for Approving Third-Party Releases

Who is being released?

What are they being released from?

Who are they being released from?

Who is Being Released?

Officers

Directors

Management

Professionals

Related entities

Equity holders

Released from what?

“Claims, counterclaims, disputes, obligations, suits, judgments, damages, demands, debts, rights, causes of action, liens, and remedies...whether liquidated or unliquidated, fixed or contingent, matured, or unmatured, known, or unknown, foreseen or unforeseen, accrued or unaccrued, existing or hereinafter arising.”

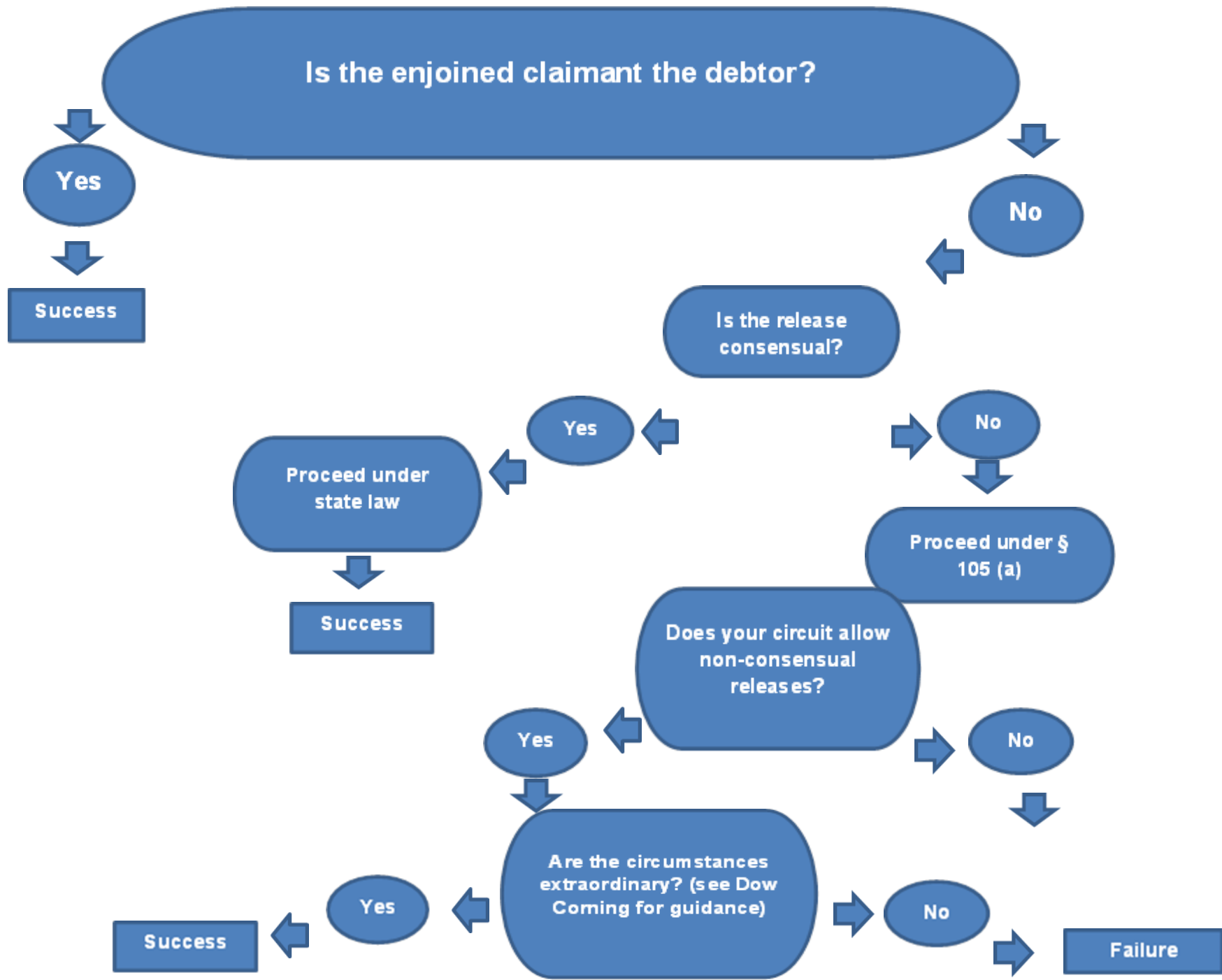
In re TK Holdings

In other words...any and everything

Released from whom?

Two options:

1. Third-parties released from the claims of the Debtor
2. Third-parties released from the claims of non-Debtors



Debtor Release of Third-Party: 1123(b)(3)(A)

A plan may provide for the “settlement or adjustment of any claim or interest belonging to the debtor or the estate.”

In other words, not all “third party releases” are controversial. If the *Debtor* is the one doing the releasing, and the release is “fair and equitable and in the best interest of creditors” such a plan provision is permissible.

Non-Debtor Release of Third-Party

Here we have the Debtor's plan controlling *two* sorts of third-parties: the third-party who holds the claim and the third-party who is being released.

Courts allow this under either because: (a) the parties consent, or (b) section 105(a) grants bankruptcy courts power to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of title 11.”

Release by Consent

- Effecting a third-party release by the consent of the third-party engenders very little judicial concern.
- Courts view these consensual releases as a simple contract under state law that just happens to be enshrined in a Debtor's chapter 11 plan.

Release without Consent: section 105(a)

- Certain courts allow, under certain circumstances, third-party releases without consent.
- But what courts?
- And under what circumstances?

Circuits That Allow Non-Consensual Releases

- Second Circuit
- Third Circuit
- Fourth Circuit
- Sixth Circuit
- Seventh Circuit
- Eleventh Circuit

Circuits That Prohibit Non-Consensual Releases

- Fifth Circuit
- Ninth Circuit
- Tenth Circuit

Circuits That Have Not Decided The Issue

- First Circuit
- Eighth Circuit

Under What Circumstances?

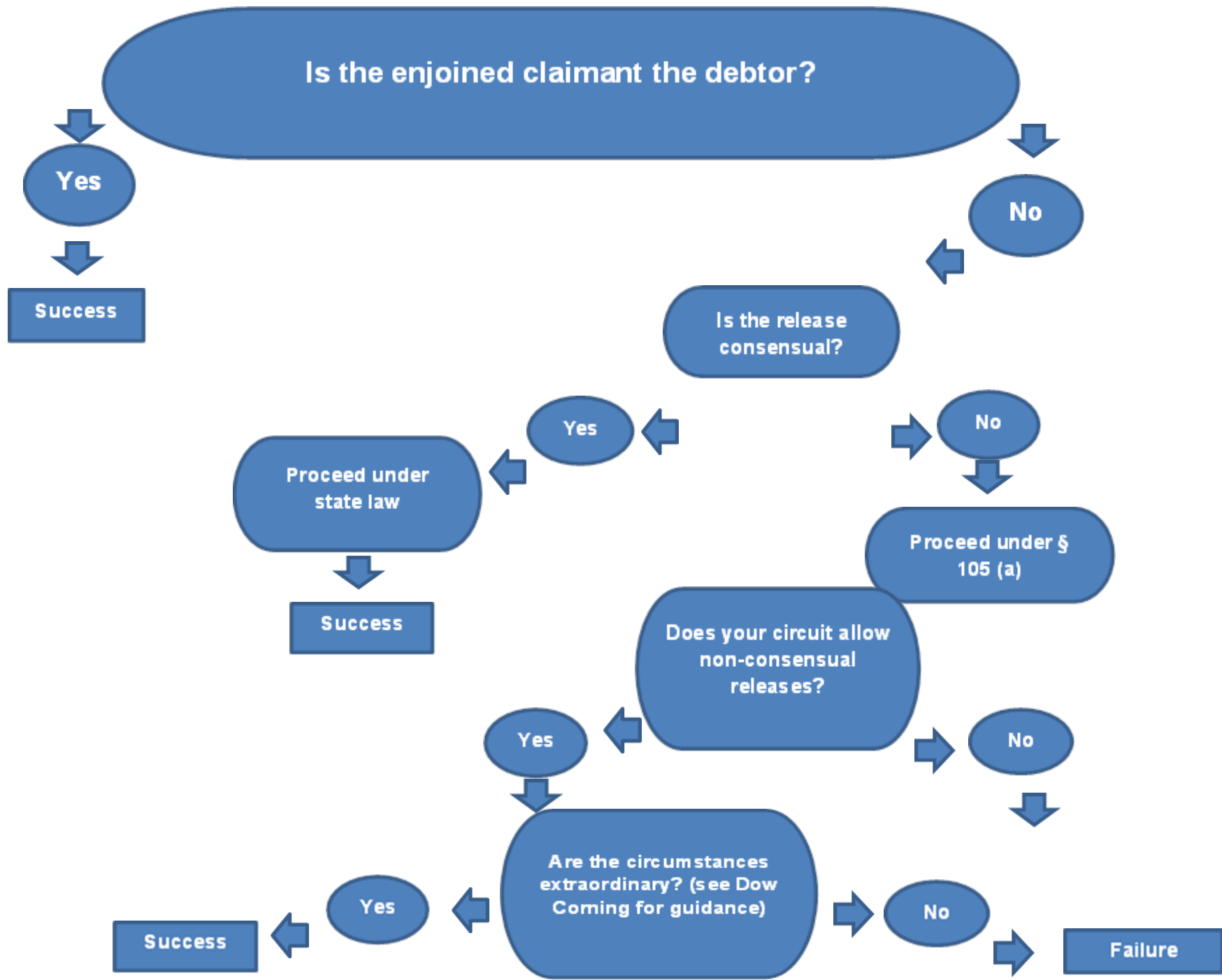
- Opinions tend to eschew a simple formula. Most use phrases like “extraordinary”, “unusual”, and “when circumstances warrant.”
- *In re Dow Corning* (6th Cir.) provides one of the most detailed standards commonly used. It has also been adopted by the 4th Circuit in *Behrmann v. National Heritage*.

The Dow Corning Standard

- 1) There is an identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate;
- 2) The non-debtor has contributed substantial assets to the reorganization;
- 3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who have indemnity or contribution claims against the debtor;
- 4) The impacted class, or classes, has overwhelmingly voted to accept the plan;
- 5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction;
- 6) The plan provides an opportunity for those claimants who choose not to settle to recover in full;
- 7) The bankruptcy court made a record of specific factual findings that support its conclusion.

Yikes, that's a tough standard...what were you saying about consent again?

- Exactly.
- Because successfully achieving a release over the clear objection of the releasing party is so difficult, the real fight often happens up-stream, at the point of consent.
- Let's go back to the flow chart.



Levels of Consent: Clear

- Details about the release is explicit and plain
- The consent, itself, is explicit and plain.
- Often this is occurs where a plan ballot contains specific information about the proposed release and provides an opt-in / opt-out box to check that is independent from a more general support of the plan.
- Courts approve these in large number

Levels of Consent: Murky

- General support of Plan, but silent on the specifics of the release
- Included in the Plan is information about the release that meets the BR 3016(c) standard.
- Bankruptcy Rule 3016(c): “If a plan provides for an injunction against conduct not otherwise enjoined under the Code, the plan and disclosure statement shall describe in specific and conspicuous language (bold, italic, or underlined text) all acts to be enjoined and identify the entities that would be subject to the injunction.”
- Cases: *In re Coram Healthcare*, *In re Arrowmill Dev. Corp.*

Levels of Consent: Muddy

- Total silence on the part of the releasing/enjoined party.
- Courts are divided on “consent by silence”.
- Case Not-Allowing Consent By Silence:
 - *In re Washington Mutual*
- Case Allowing Consent By Silence:
 - *In re Indianapolis Downs, LLC*

Finding the Principle

- The more explicit the consent, the less extraordinary the circumstances have to be for the court to approve the release. The less clear the consent, the more extraordinary the circumstances.
- At some point along that continuum, courts drift from making rulings based on state contract law and start invoking section 105.

Structuring non-debtor releases

General Comments:

Tension in Drafting Third Party Releases

Settlement Agreements

- Broader the release the better
- Release anyone and everyone from the beginning of time!

Bankruptcy Code Concerns

- Jurisdiction
- Notice
- Due Process

Structuring non-debtor releases (cont'd)

Before you draft the release, ask these questions:

- What is the debtor trying to accomplish?
- How critical is the third-party release to the plan?
- Who requires a release? And why?
- Are there less onerous means to accomplish goals?
- How will creditors and US Trustee going to react?

Structuring non-debtor releases (cont'd)

Drafting the Release in Plan

- Remember the Discharge!
- 11 U.S.C. 1141 et seq
- Powerful provisions

Structuring non-debtor releases (cont'd)

Drafting Release in Plan

- Scalpel, not a sledgehammer
- Include details in Disclosure Statement
- Be specific and precise
- Notice issues
- Be proactive – talk to people! (U.S. Trustee, Committee, key creditors)
- A “good” (but not great) release – better than no release!

Structuring non-debtor releases (cont'd)

Impairment / Opt-Out Clauses

- Impairment – alter legal, equitable or contractual rights
- Due Process / Notice Issues
- Opt-Out Clauses
 - Require affirmative act to opt out
 - Do nothing – release binds you
- Problem with opt-out clauses

Structuring non-debtor releases (cont'd)

Takata Bankruptcy

- Background
- Takata Release
 - Waiver of defenses
- Impairment / Opt-Out Issues
- Plan Balloting
- Order Confirming Plan – Release Carve Out

Analyzing and objecting to non-debtor releases

- Questions – “Who, when, where, why and how”
- Read “definitions” section of Plan first
- Search (electronically) for key terms:
 - “Causes of Action
 - “Actions”
 - “Avoidance Actions”
 - “Claims” and “Defenses”
 - “Release” and “Discharge”
- Print and keep handy key definitions
- Analyze plan sections regarding releases

Analyzing and objecting to non-debtor releases (cont'd)

- Who
 - Who is being released – “Released Parties”
 - Debtor – Reorganized Debtor
 - Officers / Employees, etc.
 - Professionals
 - Lenders / Customer
 - In what capacity are releases given?

Analyzing and objecting to non-debtor releases (cont'd)

- What
 - What claims are being released?
 - Scrutinize definitions
 - Lookout for waiver over –
 - Defenses
 - Counterclaims
 - Setoff rights

Analyzing and objecting to non-debtor releases (cont'd)

- When
 - Prepare timeline of claims subject to release
 - Beginning of time through bankruptcy filing date
 - Filing date through Plan Effective Date
 - Effective Date through _____?

Analyzing and objecting to non-debtor releases (cont'd)

Key considerations

- Does your client have a claim that may be relevant?
- Will there be ongoing relationship with debtor?
- How does plan treat claim?
- Is release contingent upon payment/distribution?
- Is creditor claim impaired? Not impaired?

Analyzing and objecting to non-debtor releases (cont'd)

Practical Guide

- Vote to reject plan (if impaired)
- Contact Debtor's counsel to address objections to release language
- If no resolution, file objection to Plan
- Seek to negotiate carve-out of release
- Know your judge