

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

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

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Agenda

- I. Basic principles of third-party releases
- II. Court standards for approving third-party releases
- III. Case law developments: third-party releases
- IV. Drafting non-debtor releases
- V. Analyzing and objecting to non-debtor releases
- VI. Pending legislation on third-party releases

Chapter 11 Plan Third-Party Release Provisions

Structuring or Objecting to Non-Debtor Releases

Basic Principles of Third-Party Releases

Ask the “who, what, why, etc.” questions

- Who is being released?
- What are they being released from?
- Who are they being released from?
- Why are they being released?

Who is Being Released?

Officers and Directors

Management / CRO

Professionals

Related entities of debtor (parents, subs)

Equity holders of debtor

Lenders / bond holders

Exit financing / capital contributions

Insurance companies

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 other words...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

*Court Standards for
Approving Third-Party
Releases*

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,” and approved by the court, the release is permissible.

Non-Debtor Release of Third Party General Rule

Courts allow this because either: (a) the parties consent, or (b) section 105(a) of the Bankruptcy Code authorizes courts 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 generally view these consensual releases as a contract under state law memorialized in a Debtor's chapter 11 plan.

Release without Consent: section 105(a)

The Court may issue any order necessary or appropriate to carry out the provisions of this title.

Position of Circuit Courts on Non-Consensual Releases

Most circuits will allow Non-Consensual Releases on a limited basis.

Three circuits will not allow Non-Consensual Releases under any circumstances.

Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
2 nd	Yes. Requires “truly unusual circumstances.” Factors: (1) release itself be important to the plan and (2) the scope of the release is necessary to the plan.*	<i>In re Drexel Burnham Lambert Grp. Inc.</i> , 960 F.2d 285 (2d. Cir. 1992). <i>In re Metromedia Fiber Network</i> , 416 F.3d 136 (2d Cir. 2005) (“finding a party has made a “material contribution” to a case was not enough and that the approval of releases requires a finding that the releases themselves are “important” and “necessary” to the plan).

**In re Metromedia Fiber Network*, 416 F.3d 136 (2d Cir. 2005).

Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
3 rd	Yes. Limited and does not appear to have established a blanket rule or set of factors to permit third-party releases. At a minimum plan must reflect fairness, necessity to the reorganization, exchange of reasonable consideration, specific factual findings relative to the factors.*	<i>In re Millennium Lab Holdings II, LLC.</i> , 945 F.3d 126 (3d Cir. 2019).

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Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
4 th	Yes. Should be imposed “cautiously and infrequently” Adopt <i>Dow Corning</i> standards. Determination that a release satisfies <i>Dow Corning</i> factors is irrelevant without specific factual findings.*	<i>In re AH Robins Co.</i> , 880 F.2d 694 (4 th Cir. 1989), <i>Natl. Heritage Found., Inc v. Highbourne Found</i> , 760 F.3d 344 (4 th Cir. 2014) (adopting <i>Dow Corning</i> standards/factors).

**In Dow Corning*, 28 F.3d 648 (6th Cir. 2002).

Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
6 th	Yes.	<i>In re Dow Corning Corp.</i> , 28 F.3d 648 (6 th Cir. 2002).

Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
7 th	Yes, <i>In re Metromedia</i> factors. Truly unusual circumstances, provision narrowly tailored and essential to the reorganization plan as a whole.*	<i>In re Airadigm Comm Inc.</i> , 519 F3d 640 (7 th Cir. 2008) (approving non-debtor release when release was necessary for the reorganization and appropriately tailored...affected only claims arising out of or in connection with the reorganization itself, not blanket immunity).

**In re Metromedia Fiber Network*, 416 F.3d 136 (2d Cir. 2005).

Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
11 th	Yes. Permitted but “ought not be issued lightly,” and should be reserved for those unusual cases in which such an order is necessary for the success of the reorganization and only in situations in which such an order is fair and equitable under the circumstances.*	<i>In re Seaside Eng’g & Surveying, Inc.</i> , 780 F.3d 1070 (11 th Cir. 2015). Adopt <i>Dow Corning</i> factors, apply flexibly/bankruptcy court discretion to decide which of the factors will be relevant in each case.

**In re Seaside Eng’g & Surveying, Inc.*, 780 F.3d 1070 (11th Cir. 2015).

Majority - Allowed – Dow Corning and Friends

Circuit:	Allow nonconsensual release?	Case(s)
D.C.	Lean yes.	<i>In re AOV Indus.</i> , 792 F.2d 1140 (D.C. Cir. 1986).

Minority - Allowed – Exceptional Circumstances, Widely Supported

Circuit:	Allow nonconsensual release?	Case(s)
1 st	Lower courts in the circuit have allowed when the factors outlined in <i>In re Master Mortg. Fund, Inc.</i> * are present and indicate extraordinary circumstances exist warranting a non-debtor/third-party release in restructuring plan.	<i>In re Chicago Investments, LLC</i> , 470 B.R. 32 (Bankr. D. Mass. 2012). (factors neither exclusive nor conjunctive requirements- simply guidance in court's determination of the fairness of the non-debtor/third-party release and its enforcement).

**In re Master Mortg. Fund, Inc.*, 168 B.R. 930, (Bankr. W.D. Mo, 1994).

Minority - Allowed – Exceptional Circumstances, Widely Supported

Circuit:	Allow nonconsensual release?	Case(s)
8 th	<p><i>In re Master Mortg. Inv. Fund, Inc.</i> factors apply. Allow compelled release if exceptional circumstances exist, release widely supported by creditor constituency (including those who will be restrained).*</p>	<p><i>In re U.S. Fidelis, Inc.</i>, 481 B.R. 503 (Bankr. E.D. Mo. 2012) allow compelled release if exceptional circumstances exist, release widely supported by creditor constituency (including those who will be restrained), constituency to be restrained receives significant benefits, creditors as a whole are being treated fairly.</p>

**In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930, (Bankr. W.D. Mo, 1994).

Minority – Disallowed - The Naysayers

Circuit:	Allow nonconsensual release?	Case(s)
5 th	No. § 524(e) only releases the debtor, not co-liable third parties.	<i>In re Pacific Lumber Co.</i> , 584 F.3d 229 (5 th Cir. 2009). <i>In re CJ Holding Co.</i> , 597 B.R. 597 (S.D. Tex. 2019). Third-party may not purchase immunity from unrelated torts, in form of non-debtor release, simply by agreeing to make a financial contribution to debtors' settlement with other creditors.

Minority – Disallowed - The Naysayers

Circuit:	Allow nonconsensual release?	Case(s)
9 th	No. Discharge under Chapter 11 releases the debtor from personal liability, does not release non-debtors/third-parties from liability.*	<i>In re Lowenschuss</i> , 67 F.3d 1394 (9 th Cir. 1995).

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Minority – Disallowed - The Naysayers

Circuit:	Allow nonconsensual release?	Case(s)
10 th	No.	<i>In re Western Real Estate Fund</i> , 922 F.2d 595 (10 th Cir. 1990) (“while a temporary stay prohibiting a creditor’s suit against a non-debtor...during the bankruptcy proceeding may be permissible to facilitate the reorganization process...the stay may not be extended post-confirmation in the form of a permanent injunction that effectively relieves the non-debtor from its own liability to the creditor.” at 601-602).

The Naysayers

- Section 524(e), relied on by the naysaying circuits, states that “[e]xcept as provided in subsection(a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”
- Section 524(a) provides the automatic injunction that a debtor gets upon discharge in a reorganization: voids any judgments and operates as an injunction against to commencement or continuation of an action to collect any such debt of the debtor
- Subsection 524(g) enjoins and channels asbestos-related claims into a trust.

Under What Circumstances?

- Courts tend to disfavor a standard formula for releases. 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.

Levels of Consent: Clear

- Details about the release are explicit and plain
- The consent, itself, is explicit and plain.
- Often this 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.

Disclosure Requirements

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.”

Levels of Consent: Muddy

- Total silence on the part of the releasing/enjoined party.
- Courts are divided on “consent by silence”.

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.

Drafting 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

Drafting 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 U.S. Trustee react?

Drafting non-debtor releases (cont'd)

Drafting the Release in Plan

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

Drafting 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!

Drafting non-debtor releases (cont'd)

Boy Scouts of America (“BSA”) Chapter 11 Bankruptcy

- Background
 - BSA (national organization) files bankruptcy
 - 275 lawsuits; 82,500 abuse claims
 - Claims against BSA and local councils
 - Local councils – separate legal entities
 - Insurance coverage

Drafting non-debtor releases (cont'd)

Boy Scouts of America case (cont'd)

- Issues
 - Who are responsible parties? BSA or local councils?
 - What insurance coverage is available?
 - Develop claims resolution process and raise money
 - Contributions from local councils
 - Contributions from BSA
 - Contributions from insurance companies

Drafting non-debtor releases (cont'd)

Boy Scouts of America – see handout

- Excerpt of Plan
 - Discharge
 - Injunction
 - Releases

Drafting non-debtor releases (cont'd)

Releases (BSA Plan)

- by Debtor and Estate of Released Parties
- by Debtor, local councils, contributing chartered organization
- by holders of abuse claims
- by holders of claims
- among contributing chartered organizations and settlement parties
- relating to insurance claims

Drafting 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

Drafting 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 of 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
 - Keep an eye on release or waiver of –
 - 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 when?

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

Pending Legislation on Third-Party Releases

In response to public outcry over *Purdue Pharma*, *BSA*, *USA Gymnastics* and other notorious third-party release Chapter 11s, there are several proposed items of legislation to amend the Bankruptcy Code to disallow them altogether.

H.R. 2096

The Stop Shielding Assets from Corporate Known Liability by Eliminating non-debtor Releases Act (the SACKLER Act) would, inter alia, amend Section 105(b) to outright ban a Bankruptcy Court from, “except as provided by section 524(g) of this title, enjoin[ing] or release[ing] a claim against a non-debtor by a State, municipality, federally recognized Tribe, or the United States.”

S. 2497

The *Nondebtor Release Prohibition Act of 2021* (the “NRPA”) would

- “eliminate the use of nonconsensual, nondebtor releases *in private claims* and those brought by the government, ensure that victims get to decide how they want their cases handled, and expand access to justice for those harmed by bad actors” by creating a new section of the Bankruptcy Code, Section 113, and
- “prohibit another abuse of the bankruptcy system, corporations’ use of so-called ‘divisional mergers’ to move their liabilities into underfunded shell companies that then declare bankruptcy”, in reference to the *Johnson & Johnson* case wherein the debtor is attempting to shield itself from liability to the tens of thousands of people who contracted cancer after using the company’s talc-based products.

Bonus Topics

- Exculpations
- Third-Party Releases in Section 363 Sales