By Jason W. Bank

Nuts and Bolts of Evaluating Third-Party Releases in Chapter 11 Plans

To release or not to release? This *should* be the question that creditors ask when reviewing chapter 11 plans. Increasingly, chapter 11 plans are including broad third-party release provisions that might be binding on creditors who take no action with respect to a plan, or fail to "opt out" of a release, thereby dramatically impacting the substantive rights of those creditors in the future. However, creditors often gloss over or simply ignore plan releases, especially when they receive significant payments. This article discusses the potential pitfalls that lurk in broad, chapter 11 plan releases and contains a nuts-and-bolts primer on how to analyze the scope, breadth and impact of releases.

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Framing the Issue of Chapter 11 Plan Third-Party Releases

There have been several opinions and a significant amount of discussion recently regarding the circumstances under which third-party releases may be authorized in chapter 11 plans without affirmative consent to the releases.[1] Some bankruptcy courts have interpreted § 1123(b)(6) of the Bankruptcy Code to authorize the inclusion of a nondebtor release of claims over a creditor's objection, as long as the release is appropriate and necessary for a debtor's reorganization.[2]

Chapter 11 plans, especially in larger cases, frequently include broad third-party releases, which become effective and binding upon a creditor who does not vote on or participate in the chapter 11 plan-confirmation process. The impact of these broad releases is especially felt by general unsecured trade creditors, who are either (1) content to vote in favor of a plan that provides them with a substantial distribution or (2) not interested in engaging counsel (and costs) to scrutinize a plan and participate in the plan-confirmation process. As a result, the rights of trade creditors are being significantly altered without their knowledge and/or participation.

In addition, many plans now contain opt-out clauses that require creditors to formally opt out of third-party releases. In most instances, taking no action or ignoring the plan means that the release will be binding upon creditors who do nothing. Some courts have held that an affirmative showing of consent is required.[3] Other courts have found that such opt-out clauses of releases can effectively bind parties who are silent.[4]

Takata: The Broad Release

The *Takata* chapter 11 case provides a good example of the current trend of plan releases and potential pitfalls that exist for the unwary creditor.[5] Takata sought bankruptcy protection in part due to the financial issues surrounding the deployment of certain defective inflators. Airbag maker Takata filed a plan that contemplated the acquisition of assets from Takata by Joyson KSS Auto Safety SA free and clear of all liens and claims.[6] The *Takata* plan contained broad release and injunction provisions impacting creditors and interested parties.

Section 10.6(b) of the *Takata* plan provided that certain released parties[7] shall be deemed forever released and discharged from "any and all 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" (the "*Takata* release").

The *Takata* plan defined "cause of action" to include "any action, Claim ... cause of action, controversy, demand, right ... defense, remedy, offset ... of any kind or character whatsoever, known or unknown, contingent or non-contingent ... whether arising before, on or after the Petition Date, in contract or in tort, at law or in equity, or pursuant to any other theory of law."[8] Section 10.5 of the *Takata*

1 For further discussion regarding third-party releases, *see* Rosa Sierra, "Warning: Artificial Consent to Third-Party Releases Will Not Result in Plan Confirmation," XXXVII *ABI Journal* 7, 28-29, 62-63, July 2018, *available at* abi.org/abi-journal.

2 *Id.* (citing *In re Airadigm Commnc'ns Inc.*, 519 F.3d 640, 657 (7th Cir. 2008)); *see also In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002).

3 *See In re Wash. Mut. Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011); *In re SunEdision Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017).

4 *See In re Ind. Downs LLC*, 486 B.R. 286, 305-06 (Bankr. D. Del. 2013) (third-party releases may bind unimpaired and impaired creditors who fail to opt out of releases); *In re Genco Shipping & Trading Ltd.*, 513 B.R. 233, 271 (Bankr. S.D.N.Y. 2014).

5 *In re TK Holdings Inc.*, No. 17-11375, 2018 WL 1306271 (Bankr. D. Del. 2018).

6 Plan of Reorganization, *In re TK Holdings Inc.*, No. 17-11375, 2018 WL 1306271 (Bankr. D. Del. 2018), Doc. No. 1629; First Amended Plan of Reorganization, *In re TK Holdings Inc.*, No. 17-11375, 2018 WL 1306271 (Bankr. D. Del. 2018), Doc. No. 2116.

7 "Released parties" was defined to mean (1) the debtors, (2) the plan administrator, (3) an oversight committee, (4) a future claims representative, (5) the plan sponsor parties, (6) the debtors' nondebtor affiliates (including the acquired nondebtor affiliates), (7) the claims administrators and, (8) with respect to each of the foregoing persons in clauses (1) through (7), such persons' predecessors, successors, assigns, subsidiaries, affiliates, managed accounts or funds, current and former officers and directors, principals, equityholders, members, partners, employees, heirs, executors, estates, servants and nominees. First Amended Plan of Reorganization at 35, *In re TK Holdings Inc.*, No. 17-11375, 2018 WL 1306271 (Bankr. D. Del. 2018), Doc. No. 2116.

8 *Id.* at 10.

plan tracks the *Takata* release language and provides for a broad injunction prohibiting creditors from pursuing claims or taking action to collect upon claims.[9]

A 13-page ballot was sent to creditors and interested parties containing the *Takata* release. The ballot and *Takata* plan provided that the *Takata* release would apply to, among other parties, (1) impaired creditors who voted in favor of the plan, (2) impaired creditors whose vote was solicited but did not vote on the plan and did not opt out of the releases, and (3) creditors deemed to reject the plan who did not opt out of granting releases. Accordingly, holders of both impaired and unimpaired claims were required to formally "opt out" of the *Takata* release; otherwise, it would be binding upon them. An unimpaired creditor who did not participate in the plan process could unknowingly be waiving defenses against future claims that could be asserted.

Legal Concerns

Opt-out clauses of releases raise legal concerns. The Bankruptcy Code provides that a class of claims or interests is impaired under a plan unless the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest."[10] Can a creditor truly be unimpaired if its rights and remedies in law and equity are being modified or released?

Opt-out clauses of broad releases also raise practical concerns for the unassuming client. Consider a trade creditor that provides parts to a debtor pre- and post-bankruptcy and post-confirmation. The plan provides that the trade creditor will be paid in full upon confirmation, provided that the trade creditor executes a release. Post-confirmation, the debtor asserts a claim against the trade creditor for warranty issues. The broad releases of "causes of action" that include defenses and other related remedies could leave the trade creditor hamstrung as it attempts to assert defenses. At a minimum, broad releases that are not closely scrutinized could create an uneven playing field in any future litigation.

A Practical Approach to Analyzing Releases in Plans

Given the landmines that potentially exist in plans containing third-party releases, it is important for practitioners to develop a strategy for analyzing these releases in a cost-effective manner so they can properly represent their clients. Creditors and interested parties might consider adopting a "journalistic approach" to analyzing releases by using the basic tenets of a "*who, what, when, where* and *how*" rubric when analyzing the scope, breadth and overall impact of releases.

Who

Traditionally, plans would only incorporate the discharge/injunction language set forth in 11 U.S.C. § 1141, and this language would only make the release applicable to the debtor (or reorganized debtor) emerging from chapter 11. In today's bankruptcy climate, the issue of who is getting released can be as confusing as the "Who's on First?" comedy routine by Bud Abbott and Lou Costello.

Accordingly, parties should closely review the list of parties that are being released. Such entities might include the following:

- the debtor;
- the reorganized debtor;
- the debtor's officers, directors, management and employees;
- financial advisors, attorneys and other professionals;
- plan sponsors/new equityholders;
- lenders;
- committees;
- liquidating trustees; and
- the debtor's key customers.

The list of released parties is often set forth in the plan's definition of "released parties." Parties should also carefully analyze the capacity in which individuals are being released. For example, are officers and directors being released in their business capacities or personally? Would a release impact a claim against a guarantor? What about the impact of a release on insurers of officers/directors?

What

Once the "*who*" has been identified, parties should next determine *what* claims are being released. The devil is in the details. A good first step would be to review the definitions in the plan for every defined term in the release. In particular, a definition like "cause of action" should be closely scrutinized to determine whether only affirmative claims against the debtor are being released and, if so, what type of claims. Is there release language including claims that are unknown or unforeseen?

Creditors need to be wary of any release that may adversely impact a party's ability to defend itself or exercise its common law or statutory rights in the future. Creditors should be especially wary regarding a release of the following:

- defenses;
- counterclaims;
- setoff or similar rights; and
- other rights afforded under applicable law.

Waiving a defense for a creditor might limit the creditor's ability to raise affirmative defenses or even contest future disputes with the debtor. This is especially problematic where a pre-petition business relationship between a debtor and creditor continues well after plan confirmation. The waiver might also have ramifications beyond the debtor/creditor relationship. A creditor might be hamstrung in its ability to pursue third parties for reimbursement of claims or coverage of defenses based on the waiver.

When

Creditors should next determine the time frames or periods that apply to the releases. Broad releases often contain no time limitations despite the fact that the Bankruptcy Code creates distinct time periods for a company going through the process. A business filing for chapter 11 becomes a debtor in possession (DIP) upon the filing of its voluntary bankruptcy

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9 *Id.* at 145.
10 11 U.S.C. § 1124(1).

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petition. On the effective date of confirmation of its plan, the business ceases to exist as a DIP and is typically referenced as a "reorganized debtor."

Releases granted by creditors under plans often go well beyond the traditional release of pre-petition (or post-petition, pre-confirmation) claims and contain no limitations as to the time period involved. Are claims prior to the effective date of a plan being released? Could the release be construed to release post-confirmation claims and defenses?

Where

Determining the scope and nature of proposed releases requires a patient and thorough reader. As is customary, plans typically rely on definitions and cross-referencing of sections. Key definitions to review include "cause of action" and "released parties." However, each plan is unique and likely uses different terminology. Creditors should carefully review any and all release and injunction provisions under the plan. Creditors should also scrutinize plan ballots regarding potential opt-out requirements.

How

How do interested parties avoid the potentially draconian impact of broad releases that might impact future defenses or other rights? The can start by taking the following steps:

1. Determine whether the release applies to your claim;
2. Determine whether your claim against a debtor is impaired or unimpaired;
3. Closely review the plan and ballot to determine whether a "yes" vote binds you to a release;
4. Determine what action, if any, you are required to take (if you are required to opt out of the release, timely follow any procedures for opting out);
5. If there are no opt-out provisions, contact debtor's counsel to discuss any concerns and attempt to negotiate a carve-out from the release in an amended plan or order confirming the plan;
6. If debtor's counsel does not address concerns, contact the U.S. Trustee or counsel for the unsecured creditors' committee to ascertain their positions; and
7. If you cannot achieve a resolution, file a timely objection to confirmation of the plan.

Conclusion

This article is not intended to debate whether third-party releases are appropriate. Many of the constituents in cases like *Takata* rely on releases to obtain finality in order to infuse capital, purchase assets or take other legitimate actions, but any consent to broad releases under plans should be well informed consent, where interested parties scrutinize release language and take action where necessary to protect their rights. abi