AMERICAN BANKRUPTCY INSTITUTE

2019 Rocky Mountain Bankruptcy Conference

CONCURRENT SESSION

# *A Fistful of Dollars*: Thorny Chapter 11 Plan Confirmation Issues and How to Address Them


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2019

# 24th Annual Rocky Mountain Bankruptcy Conference

*A Fistful of Dollars*: Thorny Chapter 11 Plan Confirmation Issues and How to Address Them
This panel will explore four challenging chapter 11 plan confirmation issues and potential ways to resolve them: (1) the appropriate cramdown interest rate; (2) the absolute priority rule; (3) plan exculpations and releases; and (4) creative ways to treat recalcitrant creditors (including unimpairment, reinstatement, contract assumption, and other means).

# *TILL*. WHAT DID IT MEAN? WHAT DOES IT MEAN?

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## INTRODUCTION

One of the most remarkable aspects of the *Till* decision, *Till v. SCS Credit Corp*., 541 U.S. 465 (2004), is that it involved a chapter 13 consumer case and, more particularly, the debtors' truck. A case wherein the U.S. Supreme Court determined the appropriate cram down rate of interest is of paramount significance to the entire financial community and to all debtors and future debtors that may seek to reorganize. And yet, the *Till* decision on that critical issue was not decided in a chapter 11 case regarding a large public debtor with multi-layers of subsidiaries. The case revolved around one of the most pedestrian fact patterns that the bankruptcy system has to deal with. It should not have been a surprise though, because only a short time before, in *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (2003), the Supreme Court decided the issue of whether a secured creditor is entitled to receive the replacement value of its collateral rather than merely liquidation value, where the debtor proposes a cram down plan and seeks to retain the collateral. As in *Till*, the *Rash* case dealt with a chapter 13 plan and the subject collateral was also the debtor's truck in a chapter 13 plan. Yet nothing, short of the direction of the reorganization process was at stake in *Rash*. Think of the difference in outcome in chapter 11 cases if a secured creditor under a plan were only entitled to receive liquidation value on account of its collateral and the remaining difference between going-concern value and liquidation value was to be divvied up among lower classes of debt and old equity. In *Rash*, the issue was how to value the truck; in *Till,* the issue was the level of interest the creditor holding a

lien on a truck was entitled to in a cram down plan. It is amazing that two cases dealing with trucks in chapter 13 have had such a significant impact on chapter 11 proceedings.

## WAS *TILL* DESIGNED TO BENEFIT DEBTORS OR SECURED CREDITORS?

What is the purpose of providing the possibility of reorganization to troubled debtors? Is the goal to keep companies operating to preserve going concern values in order to maximize creditor recoveries? Is the goal to provide debtors with an opportunity to stay in business rather than shut down? Is the goal to provide old shareholders, particularly in family businesses and entrepreneurial businesses, with a chance to fix their business and continue on? Is it all or some of the above? What about the *Till* case? Did it favor debtors (and unsecured creditors) or did it favor secured creditors? There are at least four ways to interpret *Till*. One way is to assume that the Supreme Court dictated that a formula-rate methodology was to be used by courts in setting interest rates for cram down purposes in chapter 11 or 13. This rate would start with prime and then be adjusted for risk. The adjustment would usually be in the 1% to 3% range. If *Till* is interpreted in this manner, the decision would be decidedly to the benefit debtors. In *Till,* the contract rate and market rate was 21%. That is what lenders at that time were charging for new sub-prime loans secured by trucks. However, the cram down rate was decided to be 9.5%, calculated by adding 1.5% to the then-current prime rate. It can't be doubted that this was a favorable result for the debtor; not only from the perspective that its future outlay of cash to the secured creditor was lower, but also because a lower monthly payment made the debtors likelihood of success under its plan was more feasible. Since the bankruptcy court must find a plan to be feasible in order to allow confirmation of a plan, the lower interest rate makes it easier for debtors to satisfy that confirmation standard.

The second way to interpret *Till* is that the rules are different in chapter 11 than they are in chapter 13, and for a chapter 11 plan to be successful, the cram down interest rate has to be equal to "effective rate" for loans like the cram down loan in the current lending market. That might require an analysis much like the coerced loan approach often utilized before *Till*. It might also be that an "effective rate" is something different from a coerced loan rate if an "effective rate" needs to be actually available in the market and a coerced loan rate produces a hypothetical rate even if the loan is not available to the debtor. Either result would almost always be much higher than the rate determined by the formula method and therefore would benefit the secured creditor in terms of ultimate recovery; and it would also make some plans incapable of confirmation since the debtor might not have the wherewithal to satisfy the required payments.

The third possible interpretation is that first, the bankruptcy court should determine if there is an effective rate and, if so, apply that rate. If there is not an effective rate, the formula rate must be calculated. This approach would benefit creditors if an effective rate is found by use of an approach similar to the coerced-loan methodology. On the other hand, courts may not find that an effective rate exists given the usually highly leveraged status of most debtors (particularly after the ruling in *Rash* that a creditor is entitled to realize and be paid the replacement value of its collateral in a cram down).

The fourth interpretation is that the analysis in *Till* only applies in chapter 13 cases and is not relevant in chapter 11 cases. This would benefit creditors who would have a chance to receive a better interest rate if the rate were determined by a methodology other than the formula approach.

## WHY ALL THESE INTERPRETATIONS? WHAT DID THE *TILL* CASE ACTUALLY HOLD?

*Till* was a plurality decision with four Justices participating in the plurality decision, four Justices participating in the dissent, and one Judge concurring with the plurality. The issue was how to determine the appropriate rate of interest that must be applied to the required stream of payments for a cram down plan to be approved. This issue had been a source of much contention prior to *Till* and there were at least four vastly different views of how this rate should be determined by the courts. Justice Stevens, writing for the plurality, began the analysis by pointing out that under chapter 13, a plan must accommodate a secured creditor in one of three ways.

First, the plan can be confirmed if the secured creditor assents to its treatment under the plan.

Second, the debtor may surrender the collateral to the secured creditor.

Third, the debtor may provide the creditor with a lien securing the secured claim and promise deferred payments of cash (or other property) with a value, as of the effective date of the plan, which is not less than the allowed secured claim.

The third choice is known as a "cram down" because it can be forced upon the secured creditor in the absence of its consent to the plan. This is almost identical to the requirements of cram down in a chapter 11 case. Under either chapter, a cram down requires a stream of payments that have a present value of at least the value of the collateral. If the creditor is over-secured, the secured claim is the amount of the claim. If the secured creditor is under-secured, the secured claim is the value of the collateral. Therefore, the determination of the value of the collateral is critical. Under *Rash*, the value to be used depends on the debtors proposed use of

the collateral. Therefore, if the collateral is to be used in a going concern, the value for cram down purposes is usually replacement value. The replacement value in the context of an operating business is what a willing buyer would pay for the assets in operations. If the lender holds an all-asset security interest, the replacement value of the collateral (the term used in Rash) and the going-concern value might be identical.[1]

Under either chapter 13 or chapter 11, the debtor must propose a stream of payments with an interest rate that causes the present value of the payments to be equal to at least the amount of the secured claim. After *Rash* was decided, the collateral is given it's a higher value if the debtor uses the collateral to operate. After *Rash* set a high value for collateral in a cram down, *Till* decided what interest rate must be used so that the present value of the stream of payments would equal the amount of the secured claim. If *Till* were decided in favor of lenders, then many businesses could not be reorganized because they would be required to pay the full going-concern value of the company and then add a market interest rate on that level of debt. That combination would dictate that too many reorganized debtors are reborn already overleveraged.[2] Therefore, reorganization for many debtors would not be achievable.[3] If *Till* were more debtor

[1] For purposes of this paper, the author will assume that replacement value and going concern value are identical.
[2] This may explain the number of "chapter 22s" that are filed. In those cases a debtor that had been reorganized needs to file a second chapter 11 proceeding.
[3] In today's world there are few successful free fall bankruptcies that achieve confirmation. Most cases are either pre-negotiated, where the major constituencies have agreed on the terms of the plan before the filing or involve sales of the business pursuant to section 363 of the Bankruptcy Code. More and more cases include a going-concern sale, which in essence makes chapter 11 a foreclosure vehicle for the benefit of creditors. The societal benefit of such a sale includes many of the benefits that would be realized from a traditional reorganization plan. Near going-concern value is maintained in many sale cases, because the debtor continues to operate until the sale. This is a very different result than would be realized from a state governed foreclosure where a much lower liquidation value is more likely to be realized. Jobs are often maintained and things like the benefits of marketing plans, plant structure, equipment in place, and maintenance of good will are much more likely to be preserved. Therefore, most of the hoped-for societal benefits of chapter 11 reorganizations are realized in a cheaper faster sale proceeding. What is lost are the lower-tier creditor protections embedded in the plan process and usually the hope of old equity to maintain an ownership position. Once *Rash* determined that secured creditors are entitled to the full going-concern value of an operating entity and the absolute priority rule was applied, it became very difficult for a chapter 11 proceeding to save a family business for the family or an entrepreneurial business for the entrepreneur. If the difference between going-concern value and liquidation value (the "Delta") was to be negotiated, as was the case under Chapter XI of the Bankruptcy Act (repealed effective 1979), then some of the Delta would go to secured creditors and some value

friendly then many lender's counsel perceive, debtors would be able to offset the benefit to lenders of a high value for collateral with the requirement of a lower-than-market interest rate.[4]

The *Till* case deals with how the cram down interest rate is required to be ascertained. The Supreme Court acknowledged that at least four possible solutions had been adopted by courts before the *Till* opinion.

The first is the "Coerced Loan Approach." Under this methodology, a court would need to consider what the creditor would have realized as market interest if it had foreclosed and made a new loan to a third party with the proceeds.

The second approach is the "Formula Approach," which starts with a particular reference rate, like prime, and adds a factor for the risk involved in the loan.

The third approach is the "Presumptive Contract Rate Approach," which looks to the original contract between the parties and presumes that this is the correct rate, subject to both parties' rights to seek a higher or lower rate.

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would go to unsecured creditors and old equity. There is little reason to go through the plan process to reorganize a company when closer to going concern value is realizable through a section 363 sale. The absolute priority rule seems to dictate how the proceeds will be distributed in most cases and therefor there is nothing to gain from a full-blown plan process. Of course, this analysis is very general and on a case-by- case basis, things might be handled differently. However, in terms of large trends in the way chapter 11 is practiced, the above analysis reflects the current reality. Most cases are sales (along with some pre-negotiated cases) and in most cases there is little reason to do anything else. This all works to the benefit of secured creditors. Unlike under chapter XI of the Bankruptcy Act, today, under chapter 11, lenders have confidence that if a chapter 11 is filed, they will receive the realization from their collateral in a reasonable period of time and they will receive a value approaching a going-concern value rather than foreclosure value. This has led lenders to lend deeper and deeper into balance sheets because lenders will look at collateral as having higher value in terms of likely recovery. If the collateral is worth more, the lender can advance more. This is certainly very good for lenders and stimulating more lending does tend to stimulate the economy. However, while debt is a good thing for the economy, too much debt makes it harder to recover from a recession because of the rampant overleveraging of businesses, government, and consumers. We discovered this in 2008 after the government continued to stimulate an overstimulated economy leading to massive layers of debt. I leave for the reader to determine whether current fiscal policies, monetary policies and lending trends are leading to another dangerous overleveraging. After all, it has been a long while since the last recession and the current liquidity on the system makes the next recession seem far off to many observers. However, no one has been able to outlaw the business cycle and I doubt that that has been accomplished this time either.

[4] If this is a tradeoff, it is not a very beneficial tradeoff for debtors because the benefit to lenders of the Rash case dwarf the benefits to debtors in the Till case, even if Till is ultimately interpreted in a pro-debtor manner.

The fourth methodology is the "Cost of Funds Approach," which considers what it would cost the lender to obtain a similar amount of capital from a third party.

Any of these approaches, all of which had its support in pre-Till case law, yields results which are often very different from the result using another approach. In discussing which approach is the one courts should adopt, the plurality made a pronouncement that at first appeared to yield a very pro-debtor methodology. The plurality said:

> *"[T]he Bankruptcy Court includes numerous provisions that like the cram down provision, require a court to discount … [a] stream of deferred payments back to the[ir] present dollar value we think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these under any of these provisions. Moreover, we think Congress would favor an approach that is familiar in the financial community and that minimizes the need for expensive evidentiary proceedings."*[5]

The text includes a reference to footnote 10 which lists many of the provisions the court is talking about, including specifically the chapter 11 cram down provisions. Therefore anyone reading this provision in isolation would percieve three things.

First, that the methodology for determining the cram down interest rate in chapter 13 is the same as it is in Chapter 11. [6]

Second, that determining the applicable rate should be by means familiar in the financial community.

Third, that the methodology should minimize the need for expensive evidentiary proceedings.

These are three very significant pronouncements. Some people believe that Chapter 11 practice has slowed down because of the magnitude of the professional costs incurred in such proceedings. It is significant that the Supreme Court included in its determination of the factors

[5] Till, 474-475

[6] This is a very controversial statement and as will be discussed may be diminished by footnote 14 of the Till decision which will be discussed later in this paper.

to be used in determining cram down interest rates, a requirement that courts should use a methodology which minimizes the need for expensive evidentiary proceedings. If followed, this would significantly decrease the cost of cram down fights and protect debtors from being overwhelmed by the likely cost of a cram down battle against a well-heeled adversary. It would be a significant boost to the successful use of Chapter 11 by all but the few debtors who could already afford a head to head battle with the secured creditor.

The Court also thought that the methodology utilized in determining the cram down rate should be by means familiar in the financial community. This is a benefit to the secured creditors so that the rates will not be set without a reference point that is unfamiliar to lenders.

The point that the methodology utilized should be the same in Chapter 11 as it is in Chapter 13 is the most important of all, and certainly the most controversial. The confusion boils down to be whether the Supreme Court was intending *Till* to benefit lenders by insisting that market rates be paid, or debtors by finding that a below-market rate was to be used. Is the answer the same for chapter 11 as it is for chapter 13?

**APPLYING ALL OF THIS CRITERIA, WHAT DID THE COURT DECIDE WAS THE APPROPRIATE METHODOLOGY FOR DETERMINING CRAM DOWN RATES?**

After setting forth the criteria, the plurality rejected the coerced loan, the presumptive contract rate, and the cost of funds approaches. The Coerced Loan approach was rejected because it would require the bankruptcy court to consider the market for similar loans, which the plurality believed is not the usual function of a bankruptcy court. Further, the approach would overcompensate the secured creditor because market rates of interest include consideration of the

lender's transaction costs and the lenders profits from it's business, which, the plurality asserted, are no longer relevant in setting the rates.

The plurality rejected the presumptive contract rate because it depends on the debtors prior dealings with the creditor which could lead to different results for different creditors. This approach depends on the terms of the original contract, which the plurality considered irrelevant. The plurality also rejected the Cost of Funds approach because it focuses on the creditworthiness of the creditor, not the debtor. Further it imposes a significant evidentiary burden requiring the debtor to provide expert testimony about the financial affairs and creditworthiness of the lender. The plurality did not feel that a financially unsound lender with high borrowing costs should receive a different result than a more credit worthy lender with low borrowing costs. The plurality made it clear that it does not favor a result which depends on the circumstances of the creditor. For example a poorly run or undercapitalized lender might be entitled to higher interest rates than would an efficiently run lender. Further, a lender of last resort might be entitled to higher interest rates than would a commercial bank. The plurality thought such factors were irrelevant in determining the appropriate interest rate for purposes of valuing a stream of payments, which the plurality thought should not differ depending on the identity of the creditor.

Lenders benefit from *Rash* because for cram down purposes collateral is valued at a level that is usually much higher than liquidation value. However, Till is arguably a case that benefits Debtors because it may dictate ate the use of a cram down interest rate that is almost always below a market rate of interest.

Therefore arguments by the lending community were made that the *Till* formula does not apply in chapter 11 cases notwithstanding the text surrounding footnote 10. There has been much argument that the rate set in chapter 11 should reflect a market rate of interest, even though

*Till* specifically rejected the coerced loan approach. Further, it has been argued that *Till* is merely a plurality decision and should not be binding. However it should be remembered that five Justices thought that the required approach starts with a low risk rate, like prime, and not with a coerced loan analysis, a cost of funds approach or a presumptive contract approach. The only difference between the plurality and the concurrence is whether there should be a risk adjustment to the essentially risk free rate. Five justices agreed on approach, but the concurrence went even further in saying that no risk adjustment should be made. The concurrence did not disagree with the result or the methodology and specifically approved the interest rate utilized. Further five Justices seem to have agreed that courts should use the Formula Rate Approach. The concurrence thought that the rate used should be an appropriate risk free rate[7] and seemed comfortable using prime.[8] All nine Justices agree that this is likely to yield a rate lower than market interest rate and therefore favor debtors. Why would the plurality do this? Why should Debtors not be required to pay a market rate for their post-petition financing? The plurality acknowledges that a secured creditor is entitled to be compensated because it can't use the money right away, inflation may occur diminishing the value of the downstream payments and the risk of default in payments is ever present[9] The plurality recognized that the fact that the debtor was in a proceeding indicates that the debtor is overextended but that is offset by the fact that the estate is court supervised and therefore the risk of default is lower.[10] The plurality also asserted that the task required by the statute was to provide the lender with a plan which provides the lender with a present value for a stream of payments and that does not require any analysis of

[7] Id at 487.
[8] Id at 488.
[9] Id at 474.
[10] Id at 475.

the particular creditor's proposed use of the funds or opportunity costs, such that all similarly situated lenders should receive the same cram down rate of interest.[11]

The plurality therefore rejected the coerced loan methodology, the presumptive contract rate methodology and the cost of funds methodology finding that each of the rejected methodologies is "complicated, imposes significant evidentiary costs, and aims to make each individual creditors whole rather than to ensure that the debtors payments have the required present value."[12] The plurality went on to specifically explain why the Coerced Loan methodology was rejected, including that determining the market for similar loans is not a usual function of bankruptcy judges and because the coerced loan approach would tend to overcompensate lenders because a market rate includes factors like transaction costs and profits which are not relevant to a present value analysis.[13]

The plurality specifically required the use of the formula approach because prime rate is the markets estimate of what a lender will charge a credit worthy borrower to compensate for the opportunity cost of other investments, the risk of inflation and a slight risk of non-payments.[14] thre plurality thought that an increase to the prime rate should be made to added to prime to account for *"the circumstances of the estate, the nature of the security and the duration and feasibility."*[15] The plurality did not decide on the specific adjustment that would be required, but did note that many courts allowed adjustments of 1% to 3%.[16]

The plurality also noted the statement of the dissent that the risk premium would be based upon "(1) the probability of plan failure; (2) the rate of collateral depreciation; (3) the liquidity of

[11] Id at 476-477.
[12] Id at 477.
[13] Id. at 478
[14] Id at 479
[15] Id at 479
[16] Id at 479

the collateral market; and (4) the administrative expenses of enforcement." The plurality pointed out that to the extent the debtor has information that could answer these questions that it is already included in the bankruptcy filing, and that the remaining information is far more available to the lender. Therefore requiring the lender to prove the amount of the premium is the better approach since the burden of proof is placed on the party with the best access to that information and that will lead to the most accurate results.[17]

## WHY IS THERE CONTROVERSY? WHAT SUPPORTS THE VIEW THAT TILL ALLOWS AN EFFECTIVE RATE OF CRAM DOWN INTEREST?

Based on the above, how could lenders doubt that the above-referenced text, particularly the text surrounding footnote 10, firmly establishes that setting cram down interest rates in chapter 11 requires the same methodology as required in chapter 13. After all, the language surrounding footnote 10 could not be more clear and footnote 10 refers specifically to the cram down provisions in chapter 11. If that was all the plurality wrote, the answer would in fact be perfectly clear. However, more was written. The plurality in footnote 14 suggests something very different. It says

> *"[T]here is no readily apparent Chapter 13 "cram down" market rate of interest: Because every cram down loan is imposed by a court over the objection of the secured creditor, there is no free market of willing cram down lenders. Interestingly, the same is not true in the Chapter 11 context, as numerous lenders advertise financing for Chapter 11 debtors in possession. See, e.g., Balmoral Financial Corporation, http://www.balmoral.com/bdip.htm (all Internet materials as visited Mar. 4, 2004, and available in Clerk of Court's case file) (advertising debtor in possession lending); Debtor in Possession Financing: 1st National Assistance Finance Association DIP Division, http://www.loanmallusa.com/dip.htm (offering "to tailor a financing program . . . to your business' needs and . . . to work closely with your bankruptcy counsel"). Thus, when picking a cram down rate in a Chapter 11 case, it might make sense to ask what rate an efficient market would produce. In the Chapter 13 context, by contrast, the absence of*

[17] Id at 484-485.

> *any such market obligates courts to look to first principles and ask only what rate will fairly compensate a creditor for its exposure."*[18]

At first blush, this footnote seems directly at odds with the earlier referenced language surrounding footnote 10. Since footnote 14 and the text surrounding footnote 10 seem at odds even though they are both in the same decision, debtors might argue that the language surrounding footnote 10 is what the plurality meant, while lenders might argue that footnote 14 is controlling. Since both exist in the same decision, one might assume that in drafting the decision, the Supreme Court did not find the language surrounding footnote 10 to be inconsistent with Footnote 14. That view would encourage a reader to attempt to reconcile the provisions. Some courts find that you must first look for an efficient market and if one is not found then you use the formula rate.[19] This would somewhat reconcile the provisions. The real question is when you would ever find an efficient market for cram down loan? Footnote 14 relies on advertisements it found for debtor in possession financing not exit financing. There is a big difference in Debtor in Possession Financing as compared to exit financing. It may be that exit financing might be available under certain circumstances to a particular debtor, but the author has never seen an efficient market for exit financing other than the general lending market, which would loan to ordinary borrowers but might not make a highly leveraged exit loan to a debtor. In many cases the borrowing requirement would be 100% of the asset value. This is because Rash grants full going-concern value to a secured party, so taking out the old lender would probably entail a higher level of funding than might be justified by the assets. Lenders do not tend to make new loans equal to 100% of the collateral's going concern value. If they did, they might

[18] Id at 476.
[19] *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re American Homepatient, Inc.)*, 420 F.3d 559, 568 (6th Cir. 2005) ("This means that the market rate should be applied in Chapter 11 cases where there exists an efficient market. But where no efficient market exists for a Chapter 11 debtor, then the bankruptcy court should employ the formula approach endorsed by the Till plurality."); *see also Apollo Glob. Mgmt., LLC v. Bokf, NA (In re MPM Silicones, L.L.C.*), 874 F.3d 787, 800 (2d Cir. 2017)

require an interest rate high enough to scuttle the feasibility of the plan. The Court began footnote 14 by saying that there is no readily apparent cram down interest rate in chapter 13 but that this might not be the case in Chapter 11. But does searching for a readily apparent rate involve conducting the specifically rejected coerced loan analysis? Does a readily apparent rate require an "obvious rate" that numerous market participants would charge or does it require expert testimony to establish the rate that would be charged by hypothetical lenders? In most cases in the real world such a readily apparent rate does not exist. Where the amount borrowed is equal to the value of the collateral it is unlikely that there would be a readily apparent market that would constitute an efficient market. It is possible that a readily apparent market might be found in a case where the secured debt is only a fraction of the total asset value. Certainly in today's overleveraged world that would be the minority of case. It could be that any lender would make a loan based on assets that are worth 25% of asset value and that the likely rate and term would be readily apparent. Maybe it is worth looking for an efficient rate in such cases, but even then there are usually other factors considered in the credit decision which might make the rate far from readily apparent.

**HOW DID *RASH* INFLUENCE THE DECISION IN *TILL*?**

The concurrence viewed the Rash decision and the Till decision as being interrelated. Justice Thomas wrote:

> *"Respondent argues that '"Congress crafted the requirements of section 1325(a)(5)(B)(ii) for the protection of creditors, not debtors," and thus that the relevant interest rate must account for the true risks and costs associated with a Chapter 13 debtor's promise of future payment. Brief for Respondent 24 (citing Johnson v. Home State Bank, 501 U.S. 78, 87-88, 115 L. Ed. 2d 66, 111 S. Ct. 2150 (1991)). In addition to ignoring the plain language of the statute, which requires no such risk adjustment, respondent overlooks the fact that secured creditors are already compensated in part for*

> *the risk of nonpayment through the valuation of the secured claim. In Associates Commercial Corp. v. Rash, 520 U.S. 953, 138 L. Ed. 2d 148, 117 S. Ct. 1879 (1997), we utilized a secured-creditor-friendly replacement-value standard rather than the lower foreclosure-value standard for valuing secured claims when a debtor has exercised Chapter 13's cram down option. We did so because the statute at issue in that case reflected Congress' recognition that*
>
> *'[i]f a debtor keeps the property and continues to use it, the creditor obtains at once neither the property nor its value and is exposed to double risks: The debtor may again default and the property may deteriorate from extended use.'"*

While coached in the language of statutory interpretation, this provision in the concurring decision recognized that in *Rash,* the Supreme Court had issued a very creditor-friendly decision. Justice Thomas believes that this choice was made for the purpose of reflecting the risk of default and that there was no need in *Till* to adjust the cram down interest rate to cover the risk of default for the second time.

**NOW THAT TILL HAS BEEN SO "CLEARLY" EXPLAINED, WHAT HAVE THE CASES SINCE TILL FOUND AS AN APPROPRIATE INTEREST RATE FOR CRAM DOWN?**

**VIEWS OF THE CIRCUITS**

### a. *Bank of Montreal v. Official Comm. of Unsecured Creditors (In re Am. Homepatient, Inc.),* 420 F.3d 559 (6TH Cir. 2005)

The first Circuit Court to deal with *Till's* application in chapter 11 was the Sixth Circuit in 2005. In this case, the debtor suggested that the appropriate cram down rate was 6.785%; and the lenders sought a cram down rate of 12.16%. The lower court had found the debtor's suggested rate of 6.785% to be the appropriate cram down rate after expert testimony was offered at a trial which was designed to determine the appropriate rate based on the coerced loan methodology. The expert for the Debtor testified that the coerced loan method would yield a rate

equal to six-month Treasury bill rate plus 350 basis points, which calculated out to the 6.785% rate. The lenders argued that there was no market for loans to companies where the debt was equal to the value of the assets. They argued that the market would require a combination of first-lien debt, mezzanine debt, and equity. Because mezzanine debt would, in the market, command a higher return than senior debt, and equity in the market would command a higher return than mezzanine debt, the blended rate at which this level of debt and equity investment would be 12%. The debtor put forth a coerced loan rate that was calculated in a manner very similar to the formula rate method. The debtor's expert started with the six Month Treasury Bill rate as the base rate, subject to adjustment. The lenders tried to establish what the actual market rate would be in real life, given the high loan-to-value ratio. The use of the coerced loan approach at trial by both parties occurred before the *Till* decision was issued in the Supreme Court. The Sixth Circuit's decision was issued after the *Till* decision had been rendered.

The court determined that footnote 14 of the *Till* decision meant that the use of the formula approach is not required in chapter 11 cases. The court required that an "efficient market rate" (as used in footnote 14) should be found if an efficient market exists. The court also decided that if no efficient market exists, then the determination of the appropriate interest rate should be determined by the formula method. In this case, the Court adopted the coerced loan result suggested by the debtor (even though the expert used a formula rate methodology to determine the coerced loan rate) and seemed to accept that the Supreme Court's suggestion that there may be an efficient market to mean that the result of the coerced loan method testimony could be used. While the Sixth Circuit noted that the coerced loan theory was criticized by the Supreme Court, the court also noted the Supreme Court's assertion that the coerced loan method tends to overcompensate the lender. Therefore, since the debtor was proposing a rate that could

be higher than the lender was entitled to, there was no reason to overturn the lower courts' decisions.

Another important element in the case is that the Sixth Circuit rejected the lender's plea for a blended rate even though that rate might be reflective of the actual market. The court indicated that it was not trying to provide a rate for a new first-lien loan, a mezzanine loan, or an equity investment. Rather, it was trying to find an appropriate rate for the loan in the case, which at its inception was a first-lien loan. The fact that the conditions had changed so that the debt was as high as the asset value had nothing to do, in the Sixth Circuit's view, with the appropriate cram down rate. That was based on the type of loan that was originally made - a senior loan - and not on what would be required in the market at the time of confirmation.

After all of the analysis to get to the result, the cram down rate happened to fall within the prime plus 1%-3% range discussed by the Supreme Court. The prime rate at the time of confirmation was 4.25% and the cram down rate was 6.785%, which falls within the suggested range.

### b. *Wells Fargo Bank N.A. v. Tex. Grand. Prairie Hotel Realty, L.L.C. (In re Tex. Grand Prairie Hotel Realty, L.L.C.)*, 710 F.3d 324 (5th Cir. 2013)

It was a while between circuit court decisions on the topic. But in 2013 the Fifth Circuit weighed in. In this case, the lender sought a rate of 8.8% based on a tiered lending calculation like the one that was rejected in *American Homepatient*. The debtor sought a rate of 5%, which would be prime plus 1.75. Both parties assumed that the formula approach was applicable, but they disagreed on the proper risk adjustment.

Notwithstanding both parties' assumption that *Till* required a formula method cram down rate, the court determined that *Till* was not binding precedent in a chapter 11 case. Since the issue of setting cram down rates in a chapter 11 proceeding was not before the Supreme Court in

*Till*, the Fifth Circuit felt that the *Till* case was not binding precedent on that issue. The court noted that

> *"the vast majority of bankruptcy courts have taken the Till plurality's invitation to apply the prime-plus formula under Chapter 11. While courts often acknowledge that Till's Footnote 14 appears to endorse a "market rate" approach under Chapter 11 if an "efficient market" for a loan substantially identical to the cram down loan exists, courts almost invariably conclude that such markets are absent."* [20]

In this case, the market was in fact proved to be absent. Even the lenders expert concluded that there was no lender that would make this cram down loan. The court also rejected the blended-rate loan analysis suggested by the lenders expert, pointing out that other courts have rejected this same analysis, including the Sixth Circuit, and that the rejecting courts have noted that the tiered financing proposals do not resemble the single secured loan provided by the cram down terms.

The court felt that in this case, the cram down rate of 5% was not clearly erroneous, the applicable appellate test. Further, the court pointed out that the prime-plus method had been endorsed by a plurality of the Supreme Court, and had been adopted by the "vast majority of bankruptcy courts," and was believed to be controlling by both parties in the case. However, the Sixth Circuit concluded by stating "we do not suggest that the prime-plus formula is the only-or even the optimal-method for calculating the Chapter 11 cram down rate".[21] Therefore the Fifth Circuit has carved out great leeway for lower courts to use in determining cram down rates. It is obvious that the drafter of the opinion is not a fan of the *Till* plurality decision or of that decision being followed by most bankruptcy courts. He tends to agree with the *Till* dissent that lenders are being systematically underpaid by the use of the formula rate. He makes no reference to the tremendous lender victory in *Rash*. In fact, he asserts that any court following *Till* is doing so not because it is binding but because it is persuasive. Once again, the result in the case is consistent with a prime plus 1%-3% conclusion.

[20] In re Texas Grand Prarie at 334.
[21] *Id.* at 337.

### c. *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying (In re Seaside Eng'g & Surveying)*, 780 F.3d 1070 (8th Cir. 2015)

This case dealt with a myriad of other issues, including the issuance of third-party releases. Therefore, it dealt with cram down interest in a cursory fashion. The issue was whether the bankruptcy court had committed clear error in setting cram down interest rates. The bankruptcy court had applied the formula rate of prime plus1%. The Eighth Circuit noted that the Supreme Court had approved the formula rate and it had been properly applied by the bankruptcy judge. The risk adjustment of 1% was within the range suggested by the Supreme Court. Therefor no clear error was committed. It seems that in the Eleventh Circuit, the formula approach probably prevails.

### d. *First Southern Nat'l Bank v. Sunnyslope House. L.P. (In re Sunnyslope Hous. L.P.)*, 859 F.3d 637 (11th Cir. 2017)

This was a case much like *Seaside* where there were many issues and the interest rate was not the court's primary focus. The issue in *Sunnyslope* regarding interest rates was whether the bankruptcy court had committed clear error in setting the cram down interest rate.

In this case the interest rate chosen was 4.4% and the prime was 3.25. The Eleventh Circuit approved of the bankruptcy court applying a formula rate and felt that the particular finding of the applicable risk adjustment was well reasoned. Here again, the Circuit Court supported the use of the formula approach of *Till* and the rate was within the 1%-3% range.

### e. *Apollo Global Mgmt., LLC v. Bokf, NA (In re MPM Silicones, L.L.C.)*, 874 F.3d 787 (2nd Cir. 2017)

In this matter, the Court of appeals believed that the lower courts had committed clear error by applying the formula rate to determine cram down interest. The cram down rates

applied were between 4.1% and 4.85%. The noteholders argued that there is a market rate for loans like the cram down loan and that the market rate would be in the range of 5%-6% or even more. The bankruptcy court (and the district court) felt that the rate needed to be set by the formula approach required by *Till*. Those courts felt that market factors were not relevant in setting the cram down interest rate. The court of appeals noted *Till's* suggestion that the method to determine the rate in a chapter 11 is the same as in chapter 13. The court also noted footnote 14, which suggests looking to an efficient rate in chapter 11 but not in chapter 13. The Second Circuit adopted the Sixth Circuit's approach of determining whether an efficient market exists and if not, applying the formula approach. This result was thought to be consistent with *Till* and also reflects the Supreme Court's admonition in *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. Lasalle St. P'ship*, 526 U.S. 434 (1999), that determining fair-market value is best done by employing a competitive process rather than having a court set the value. *N. Lasalle* was a case determining the fair-market value of property and not a case where cram down interest is being set. The Circuit Court felt that determination of the efficient market rate is within the competence of bankruptcy courts[22]. The case was remanded with instructions to ascertain whether an efficient market exists and if so apply that rate instead of the formula rate. The Second Circuit seems to understand that a formula approach undercompensates a lender. The plurality in the Supreme Court thought that a market rate of interest overcompensates a lender for what it is entitled to in a cram down, and that there are factors in market rates, like "lenders"

[22] It is interesting that the Supreme Court in *Till* did not agree. Till at_477_. The plurality believed that "[T]he coerced Loan approach requires the bankruptcy court to consider evidence about the market for comparable loans to similar (though non bankruptcy) debtors—an inquiry far removed from such court's usual tasks of evaluating debtors' financial circumstances and the feasibility of their debt adjustment plans." 541 U.S. at 477.

transaction costs and overall profits, that are no longer relevant in the context of court-administered and court-supervised cram down loans." [23]

## CONCLUSION

The goal of these materials was to explore what *Till* meant when it was issued and what it means today. The reality is that *Till* is no less a mystery today than it was when it was issued. *Till* was a perfectly understandable opinion until a reader came to footnote 14. It was certainly hard to understand footnote 14 after the very clear language surrounding footnote 10. The author thinks that the Fifth Circuit was correct in *Texas Grand Prairie* that so far most bankruptcy courts have use the formula methodology and that courts that look for an effective rate usually discover that none exists. Maybe that is the answer. Some Federal Courts of Appeal seem satisfied with the formula approach and others think that a search for an effective market is required before the formula test is used. Is an effective market a real market consisting of real lenders? Is the search for an effective market simply a rebirth of the search for a hypothetical rate via the coerced loan approach? The Supreme Court plurality described the effective rate as a readily apparent rate. That might be very different from the result from a coerced loan analysis. In MPM Silicones, it appeared that there was actually may have been a readily apparent available market for loans very similar to the cram down terms. In many cases, the debtor is left overleveraged because of the valuation required in Rash, and an effective rate is hard to imagine. Maybe courts will continue to find no effective market in those cases. In an

[23] Id at 477

article published in the ABI Journal in December 2005[24], my co-author, Adrienne K. Walker and I stated that:

> *"It will be interesting to watch how bankruptcy courts in the future will apply Till in chapter 11 cases. Some courts may determine that there is no efficient market rate applicable and may apply a formula rate within the prime-plus-1-to-3-percent range. Other courts may determine that there is no efficient market rate applicable, but may differ significantly in determining the premium over prime to be applied. Other courts may search for an applicable efficient market rate with widely varying results. Therefore, while Till could be construed in a manner that will provide the opportunity for increasing numbers of chapter 11 debtors to successfully restructure their businesses, Till might only have established a new path leading to the familiar result: future decisions with conclusions just as diverse as they were before Till."*

Thirteen years later that still seems about right. I would differ in degree with respect to the last sentence. Till, if construed in a debtor oriented manner, will make reorganizations more available for debtors. However, not by the magnitude that it might have. The pull from Rash has proved more powerful than the push from Till. Also, while there certainly have been markedly diverse decisions, as anticipated, I am not sure that post -Till diversity rises to the same level as existed pre-Till.

[24] Mikels and Walker, Column:, On The Edge, The Developing Impact of Till v. SCS on chapter 11 Reorganizations, 24-10 ABIJ 12 2005)

# Exculpations and Releases in Chapter 11 Plans

Hon. Michael E. Romero
U.S. Bankruptcy Court for the District of Colorado

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## Exculpations and Releases in Chapter 11 Plans

Typically three kinds of releases in Chapter 11 plans:

1) Exculpations – releases of claims against the debtor's directors, officers, similar managing persons, and professionals, the unsecured creditors' committee and its professionals, and certain other parties based on their qualified immunity for conduct, except for gross negligence and willful misconduct, occurring during the Chapter 11 case.

2) Debtor releases – releases of claims held by the debtor against specific non-debtors, or mutual releases between the debtor and non-debtors.

3) Non-debtor third-party releases – releases of claims held by non-debtor third parties against other non-debtor third parties.

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## Exculpation Provisions

Generally, exculpations provide qualified immunity to the debtor's directors, officers, similar managing persons, and professionals, the unsecured creditors' committee and its professionals, and certain other parties with respect to conduct, except for gross negligence and willful misconduct, occurring during the chapter 11 case.

Exculpations "encourage[e] parties to engage in the process and assist the debtor in achieving a confirmable plan — actions that committees, committee members, other estate representatives and their professionals, and certain parties (such as key lenders) may not be willing to undertake in the face of litigation risk." ABI Comm'n. to Study Reform of Chapter 11 Final Report and Recommendations (2014) at 251.

Properly drafted, an exculpation should fall outside 11 U.S.C. § 524(e). Exculpation provisions should merely restate the standard to which estate fiduciaries generally are held in a Chapter 11 case. *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3rd Cir. 2000) (where release "does not affect the liability of third parties, but rather sets forth the appropriate standard of liability, [it] is outside the scope of § 524(e)."). Thus, even in jurisdictions where non-debtor third-party releases are prohibited by 11 U.S.C. § 524(e), courts have permitted exculpation provisions in Chapter 11 plans. *See In re Pac. Lumber Co.*, 584 F.3d 229, 253 (5th Cir. 2009) (striking all non-debtor releases under section 524(e) except for the exculpation provided to creditors' committee and its members).

3

## Exculpation Provisions

Bankruptcy Code does not specifically provide for inclusion of exculpation provisions in Chapter 11 plans.

Generally, the statutory basis for the qualified immunity underlying exculpations is found in 11 U.S.C. § 1103(c):

> (c) A committee appointed under section 1102 of this title may—
>
> (1) consult with the trustee or debtor in possession concerning the administration of the case;
>
> (2) investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan;
>
> (3) participate in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan;
>
> (4) request the appointment of a trustee or examiner under section 1104 of this title; and
>
> (5) perform such other services as are in the interest of those represented.

"Section 1103(c) of the Bankruptcy Code, which grants to the Committee broad authority to formulate a plan and perform 'such other services as are in the interest of those represented,' 11 U.S.C. § 1103(c), has been interpreted to imply both a fiduciary duty to committee constituents and a limited grant of immunity to committee members." *In re PWS Holding Corp.*, 228 F.3d 224, 246 (3rd Cir. 2000).

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## Exculpation Provisions

*Who May Be Exculpated?*

Releases provided by an exculpation provision are limited to only those who are "estate fiduciaries" who served during the Chapter 11 case:

- Committees and their members;
- The debtors' officers and directors; and
- Estate professionals who provided services to either during the bankruptcy case.

"The exculpation clause must be limited to the fiduciaries who have served during the chapter 11 proceeding: estate professionals, the Committees and their members, and the Debtors' directors and officers." *In re Washington Mutual, Inc.*, 442 B.R. 314, 350-51 (Bankr. D. Del. 2011); *see also In re PWS Holding Corp.*, 228 F.3d 224, 246 (3rd Cir. 2000) ("committee members and the debtor are entitled to retain professional services to assist in the reorganization.").

Provision will either be rewritten or stricken if it includes non-fiduciaries. *See In re Midway Gold U.S., Inc.*, 575 B.R. 475, 512-13 (Bankr. D. Colo. 2017); *see also In re Tribune Co.*, 464 B.R. 126, 189 (Bankr. D. Del. 2011) (exculpation provision must exclude non-fiduciaries).

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## Exculpation Provisions

*What May Be Exculpated?*

Estate fiduciaries are entitled to qualified immunity for any acts or omissions during a Chapter 11 case within the scope of their duties. *In re PWS Holding Corp.*, 228 F.3d at 246 ("This immunity covers . . . actions within the scope of their duties."); *In re Bigler, LP*, 442 B.R. 537, 545-46 (Bankr. S.D. Tex. 2010) (citing *In re Pilgrim's Pride Corp.*, 2010 WL 200000, at *4 (Bankr. N.D. Tex. 2010) (". . . committees and their members are entitled to qualified immunity for any acts or omissions during a [C]hapter 11 case that were within the scopes of their duties.")).

The qualified immunity afforded estate fiduciaries does not include:

- Gross negligence or willful misconduct.
- Acts outside the scope of fiduciary's duties in a Chapter 11 case.
- Acts outside the pendency of the Chapter 11 case. Conduct taking place *before* Chapter 11 case may not be exculpated, and should not extend to acts or omissions *after* the case ends or the fiduciaries' duties cease.

Properly drafted exculpation provisions should simply restate the standard to which estate fiduciaries generally are held in a Chapter 11 case.

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## Debtor Releases

Generally, these are releases by the debtor of specific non-debtors for claims belonging to the estate arising before or during the Chapter 11 case. Tend to arise in the context of plan negotiations and provide an incentive for creditors or other third parties to contribute to a reorganization (*e.g.*, providing financing or other new value, allowing use of cash collateral, supporting and soliciting acceptance of the plan, or accepting a discount on their claims).

Typically non-controversial because they are specifically governed by 11 U.S.C. § 1123(b)(3)(A), which allows for a plan to provide for "the settlement or adjustment of any claim or interest belonging to the debtor or the estate."

Approval of a debtor release under 11 U.S.C. § 1123(b)(3)(A) generally requires court to apply standard for settlements under Fed. R. Bankr. P. 9019. "[A] debtor may release claims in a plan pursuant to Bankruptcy Code § 1123(b)(3)(A), if the release is a valid exercise of the debtor's business judgment, is fair, reasonable, and in the best interests of the estate." *In re Spansion*, 426 B.R. 114, 142-43, n. 48 (Bankr. D. Del. 2010); *see also In re NII Holdings, Inc.*, 536 B.R. 61, 98 (Bankr. S.D.N.Y. 2015) ("Courts analyze settlements under section 1123 by applying the same standard applied under Rule 9019[.]").

In *Midway Gold*, U.S. Bankruptcy Court for the District of Colorado approved debtor releases of secured parties based on evidence global settlement was product of good-faith arm's length negotiations, released parties provided post-petition financing and other consideration, including consenting to use of cash collateral, released parties would not have consented to plan absent releases, and debtors would not otherwise have been able to proceed through confirmation and provide recovery on general unsecured claims without assistance of released parties. *In re Midway Gold U.S., Inc.*, 575 B.R. 475, 509-10 (Bankr. D. Colo. 2017).

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## Debtor Releases

Some courts also consider the specific facts and equities of each case, examining five factors articulated under *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930, 937 (Bankr. W.D. Mo. 1994):

(1) an identity of interest between the debtor and non-debtor such that a suit against the non-debtor will deplete the estate's resources;

(2) a substantial contribution to the plan by the non-debtor;

(3) the necessity of the release to the reorganization;

(4) the overwhelming acceptance of the plan and release by creditors and interest holders; and

(5) the payment of all or substantially all of the claims of the creditors and interest holders under the plan.

*See In re Zenith Electronics Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999); *see also In re Washington Mutual, Inc.*, 442 B.R. 314, 346, n. 33 (Bankr. D. Del. 2011); *see also In re Exide Technologies*, 303 B.R. 48, 71-72 (Bankr. D. Del. 2003).

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## Debtor Releases

*Who is Granting the Release?*

Section 1123(b)(3)(A) allows a plan to provide for "the settlement or adjustment of any claim or interest belonging to the debtor or the estate."

Releases should be limited to the debtor(s) and the estate(s). *See In re Midway Gold U.S., Inc.*, 575 B.R. 475, 507 (Bankr. D. Colo. 2017) ("Releases by third-party non-debtors must be separately identified because . . . such releases are reviewed under a different standard.") (citing *In re Washington Mutual, Inc.*, 442 B.R. 314, 346, n. 33 (Bankr. D. Del. 2011)).

*Who is Being Released?*

Typically non-debtor third parties (*e.g.*, creditors and pre-petition lenders, and other third parties and their advisors) who contributed to the reorganization.

Courts will separately evaluate each released party to determine whether the release is reasonable and/or permissible.

Proposed debtor releases may also include the committee and its members, and debtor's or committee's directors, officers, employers, representatives, and professionals who served during Chapter 11 case. However, these may be unnecessarily duplicative of exculpations granted in other parts of the Chapter 11 plan. Additionally, releases of debtor's officers, directors, and employees may also be rejected if there is no evidence they made any "substantial contribution" to the case, or if they were not necessary to the reorganization. *See In re Washington Mutual, Inc.*, 442 B.R. 314, 349-50 (Bankr. D. Del. 2011).

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## Non-debtor Releases

Chapter 11 plans may seek to extinguish claims held by non-debtor third parties against other non-debtor third parties.

Circuit Courts of Appeals are split on whether a bankruptcy court may confirm a Chapter 11 plan containing non-debtor third party releases.

Majority View – The Second, Third, Fourth, Sixth, Seventh, and Eleventh Circuits have held non-debtor third-party releases in a Chapter 11 plan may be approved under certain circumstances and when certain standards are met.

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

*Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203 (3rd Cir. 2000)

*Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704 (4th Cir. 2011)

*In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002)

*In re Aradigm Comms., Inc.*, 519 F.3d 640 (7th Cir. 2008)

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

Bankruptcy courts in the First and Eighth have agreed with the majority view. *See In re Archdiocese of Saint Paul and Minneapolis*, 578 B.R. 823 (Bankr. D. Minn. 2017); *see also In re Mahoney Hawkes, LLP*, 289 B.R. 285 (Bankr. D. Mass. 2002).

Minority View – The Fifth, Ninth and Tenth Circuits have held 11 U.S.C. § 524(e) prohibits third party releases.

*In re Pac. Lumber Co.*, 584 F.3d 229 (5th Cir. 2009)

*Resorts International, Inc., v. Lowenschuss*, 67 F.3d 1394 (9th Cir. 1995)

*In re Western Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990), *modified sub nom., Abel v. West*, 932 F.2d 898 (10th Cir. 1991))

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## Non-debtor Releases – Majority View

Generally

Courts following the majority view hold 11 U.S.C. 524(e) is not an absolute bar on a bankruptcy court's ability to approve a non-debtor third party release. *See In re Aradigm Comms., Inc.*, 519 F.3d 640, 656 (7th Cir. 2008) (a "natural reading of [§ 524(e)] does not foreclose a third-party release from a creditor's claims.") (citing *Matter of Specialty Equipment Companies, Inc.*, 3 F.3d 1042, 1046-47 (7th Cir. 1993) ("while section 524(e) has generally been interpreted to preclude the discharge of guarantors, the statute does not by its specific words preclude all releases that are accepted and confirmed as an integral part of a reorganization.")); *see also In re Dow Corning Corp.*, 280 F.3d 648, 657 (6th Cir. 2002) ("language [of § 524(e)] explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor.").

11 U.S.C. § 524(e) prevents a court from enjoining a creditor's attempt to collect a debt from a co-debtor even if that debt was discharged as to the debtor in the Chapter 11 plan. *In re Aradigm Comms., Inc.*, 519 F.3d at 656. This is consistent with *Western Real Estate*. However, the majority view holds Section 524(e) does not purport to limit a bankruptcy court's powers to release a non-debtor from a creditor's claims for which the debtor is not also liable. *In re Seaside Engineering & Surveying, Inc.*, 780 F.3d 1070, 1078-79 (11th Cir. 2015); *In re Aradigm Comms., Inc.*, 519 F.3d at 656.

Courts subscribing to the majority view also hold the bankruptcy court's broad equitable powers under 11 U.S.C. § 105(a) permit approval of third-party releases in Chapter 11 plans in appropriate circumstances. *See In re Aradigm Comms., Inc.*, 519 F.3d at 657 ("residual authority" under Section 105(a) "permits the bankruptcy court to release third parties from liability to participating creditors if the release is 'appropriate' and not inconsistent with any provision of the bankruptcy code.").

Reading 11 U.S.C. § 105(a) together with 11 U.S.C. § 1123(b)(3)(A) (plan may provide for "the settlement or adjustment of any claim or interest belonging to the debtor or the estate") and 11 U.S.C. § 1123(b)(6) (plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title"), enjoining a creditor's claims against a non-debtor may be necessary, and within the bankruptcy court's authority, to achieve a successful reorganization.

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## Non-debtor Releases – Majority View

Standards for Approving Non-Debtor Releases

Courts in the majority view are in agreement such provisions are proper only in rare cases.

> "[S]uch a release is proper only in rare cases . . . [because it] is a device that lends itself to abuse." *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141-42 (2nd Cir. 2005)
>
> "[S]uch an injunction is a dramatic measure to be used cautiously . . . [and] only appropriate in 'unusual circumstances'." *In re Dow Corning Corp.*, 280 F.3d 648, 657-69 (6th Cir. 2002)
>
> Majority view has "adopted a more flexible approach, albeit in the context of extraordinary cases." *Gillman v. Continental Airlines (In re Continental Airlines)*, 203 F.3d 203, 212-13 (3d Cir. 2000)
>
> "[P]rudence demands that third-party releases be viewed with a healthy dose of skepticism." *In re Berwick Black Cattle Co.*, 394 B.R. 448, 460 (Bankr. C.D. Ill. 2008)

Additionally, some courts have concluded the justification for third-party releases is far less compelling in a liquidating Chapter 11 plan than in a reorganization. In an reorganization, as opposed to a liquidation, a debtor needs to be protected from suits which may deplete its assets. *See In re SL Liquidating, Inc.*, 428 B.R. 799, 803 (Bankr. S.D. Ohio 2010); *see also In re Berwick Black Cattle Co.*, 394 B.R. at 461.

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## Non-debtor Releases – Majority View

Standards for Approving Non-Debtor Releases

Courts in the First and Eighth Circuits have allowed third-party non-debtor releases when the factors outlined in *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994), are balanced. *See In re Mahoney Hawkes, LLP*, 289 B.R. 285, 299-303 (Bankr. D. Mass. 2002) (adopting the *Master Mortgage* multi-factor test to determine necessity for non-debtor third-party injunctions, but finding plan provisions did not satisfy factors warranting issuance of permanent injunction) (citing *In re Master Mortg. Inv. Fund, Inc.*, 168 B.R. 930, 935 (Bankr. W.D. Mo. 1994)); *see also In re U.S. Fidelis, Inc.*, 481 B.R. 503, 519 (Bankr. E.D. Mo. 2012) (finding *Master Mortgage* requirements fulfilled).

The *Master Mortgage* factors are:

(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 assets of the estate.

(2) The non-debtor has contributed substantial assets to the reorganization.

(3) The injunction is essential to reorganization. Without the it, there is little likelihood of success.

(4) A substantial majority of the creditors agree to such injunction, specifically, the impacted class, or classes, has "overwhelmingly" voted to accept the proposed plan treatment.

(5) The plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.

The Third Circuit has not adopted a specific test for when such releases are appropriate, but the U.S. Bankruptcy Court for the District of Delaware has held third party releases are permissible if they meet the *Master Mortgage* factors and the standard of fairness and necessity to the reorganization set forth by *In re Continental Airlines*, 203 F.3d 203.(3d Cir. 2000). *In re Millenium Lab Holdings II, LLC*, 575 B.R. 252, 272 (Bankr. D. Del. 2017); *see also In re Washington Mutual, Inc.*, 442 B.R. 314, 346-47 (Bankr. D. Del. 2011) ("Determining the fairness of a plan which includes the release of nondebtors requires the consideration of numerous factors and the conclusion is often dictated by the specific facts of the case.") (citing *In re Continental Airlines*, 203 F.3d at 212-14); *see also In re Zenith Elecs. Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999) (in considering debtor's release of third parties, court applied *Master Mortgage* five factor test).

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## Non-debtor Releases – Majority View

Standards for Approving Non-Debtor Releases

The Second and Seventh Circuits have not applied a specific set of factors, but allowed third-party non-debtor releases when truly "unusual circumstances" exist.

In *In re Metromedia Fiber Network, Inc.*, the Second Circuit held: "A nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to the success of the plan" and where the scope of the release is necessary to the plan. *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 141-42 (2nd Cir. 2005). The Second Circuit stated the test is not "a matter of factors and prongs," and a third party release will not be tolerated "absent findings of circumstances that may be characterized as unique." *Id.* at 142.

Based on other courts' approvals of nondebtor releases, the Second Circuit also found the court should consider whether the estate received substantial contribution, the enjoined claims were "channeled" to a settlement fund rather than extinguished, the enjoined claims would indirectly impact the debtor's reorganization "by way of indemnity or contribution," the plan otherwise provides for the full payment of the enjoined creditors, and whether the affected creditors consent. *Id.* at 142-43.

In *In re Aradigm Communications, Inc.*, the Seventh Circuit held whether a release is appropriate is a fact intensive inquiry and dependent on the nature of the reorganization, and only where the release "was necessary for the reorganization and appropriately tailored." *In re Aradigm Comms., Inc.*, 519 F.3d 640, 657 (7th Cir. 2008).

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## Non-debtor Releases – Majority View

Standards for Approving Non-Debtor Releases

The Sixth Circuit agrees "that enjoining a non-consenting creditor's claim is only appropriate in 'unusual circumstances.'" *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002). In *In re Dow Corning Corp.*, the Sixth Circuit held a bankruptcy court may enjoin a non-consenting creditor's claims against a non-debtor when the following seven factors are present:

(1) There is an identity of interests 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 would 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; and

(7) The bankruptcy court made a record of specific factual findings that support its conclusions.

The Fourth and Eleventh Circuits have followed the *Dow Corning* factors as well. *See In re Seaside Engineering & Surveying, Inc.*, 780 F.3d 1070, 1079 (11th Cir. 2015) ("The factors should be considered a nonexclusive list of considerations, and should be applied flexibly, always keeping in mind that such bar orders should be used 'cautiously and infrequently,' and only where essential, fair, and equitable.") (quoting *In re Munford*, 97 F.3d 449, 455 (11th Cir. 1996)); *see also Behrmann v. Nat'l Heritage Found.*, 663 F.3d 704, 712 (4th Cir. 2011).

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## Non-debtor Releases – Majority View

Jurisdiction/Authority

*In re Digital Impact, Inc.*, 223 B.R. 1 (Bankr. N.D. Okla. 1998) – Although funding contributed by non-debtor party would undoubtedly have an effect upon the estate, Court lacked subject matter jurisdiction over actions subject to third party releases where outcome of those proceedings would have no effect upon the estate. The "proceeding" that must be examined to determine whether it is "related to" the Chapter 11 case is the potential post-confirmation proceeding between the non-debtor third parties. Court found third-party release was equivalent to issuing final adjudication on the merits of such a claim, and court lacked jurisdiction to adjudicate claim having no effect on the estate after administration of the estate is complete.

*In re Midway Gold U.S., Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017) – Court found it lacked "related to" subject matter jurisdiction to enjoin or release non-debtor third party causes of actions against non-debtors where, based on the court's reading of third party release, the claims may not have any conceivable effect on the debtors or the estates. Court also held fact the non-debtor released parties may have contributed financially to the plan was insufficient by itself for the court to find it can exercise "related to" jurisdiction over the claims being released. Although possibility of contribution or indemnification claims by third parties pay support finding of "related to" jurisdiction, no evidence of such agreements was presented.

*In re Millennium Lab Holdings II, LLC*, 575 B.R. 252 (Bankr. D. Del. 2017), *aff'd In re Millennium Lab Holdings II, LLC*, 2018 WL 4521941 (D. Del. Sept. 21, 2018) – Concluding bankruptcy court had at least "related to" subject matter jurisdiction and constitutional adjudicatory authority to enter final order confirming plan containing non-consensual third party releases. Plan confirmation is the relevant "proceeding" for determining whether bankruptcy court can exercise "related to" jurisdiction over third party releases. Adjudication is only of the plan under 28 U.S.C. § 157(b)(2)(L), and not the underlying claim. Thus, court had statutory authority to enter a final judgment on confirmation of a plan under *Stern v. Marshall* because confirmation of plan is an enumerated core proceeding under 28 U.S.C. § 157(b)(2)(L). Further, court has constitutional authority under *Stern v. Marshall* because an order confirming a plan with releases does not rule on the merits of the state law claims being released. The Third Circuit has ruled *Stern v. Marshall* does not prevent a bankruptcy judge from entering final orders in statutorily core proceedings notwithstanding the order's collateral impact on state law claims.

*In re Kirwan*, 2018 WL 5095675, *9 (S.D.N.Y. Oct. 10, 2018) – Concluding bankruptcy court had jurisdiction to consider a non-debtor release in connection with a Chapter 11 plan, but noting a third-party release must be sufficiently related to the issues before the court in order for core jurisdiction to cover an order extinguishing the third-party's claim. The bankruptcy court acts pursuant to its core jurisdiction under 28 U.S.C. § 157(b)(2)(L) when it considers the involuntary release of claims against a third-party, non-debtor in connection with the confirmation of a plan. A confirmed plan including releases does not address the merits of the claims being released. That a bankruptcy court's decision may have a preclusive, incidental effect on claims beyond the scope of the immediate bankruptcy proceeding does not render the bankruptcy court's jurisdiction non-core. *Stern v. Marshall* "lends clear support for the conclusion that a non-core matter that arises in connection with a core proceeding renders that matter core, for purposes of determining a bankruptcy court's subject matter jurisdiction, as long as the non-core matter is sufficiently related to the core proceeding." The bankruptcy court explicitly found it could not have adjudicated the debtor's reorganization under 28 U.S.C. § 157(b)(2)(L) without including the third-party releases.

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## Non-debtor Releases – Majority View

Consent to Third Party Releases

*How do debtors obtain consent to the third-party releases?*

"Courts generally agree that an affirmative vote to accept a plan that contains a third-party release constitutes an express consent to the release." *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017); *In re Chassix Holdings, Inc.*, 533 B.R. 64, 79 (Bankr. S.D.N.Y. 2015) (noting "many courts have treated a vote in favor of a Plan as a 'consent' to third party releases.") (citing *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2nd Cir. 2005); *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047 (7th Cir. 1993); *In re MPM Silicones, LLC*, 2014 WL 4436335, at *32 (Bankr. S.D.N.Y. Sept. 9, 2014)).

*What if creditor fails to vote?*

Some courts have held non-voting creditors were deemed to consent to third party release. *See In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013) ("As for those impaired creditors who abstained from voting on the Plan ... the record reflects these parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots. Under these circumstances, the Third Party Releases may be properly characterized as consensual and will be approved."); *Spansion*, 426 B.R. at 144 (overruling U.S. Trustee's objection to deemed consent to third party release by non-voting, unimpaired class where no member of the class objected); *In re DBSD N. Am., Inc.*, 419 B.R. 179, 218 (Bankr. S.D.N.Y. 2009) (creditors entitled to vote who abstained and chose not to opt out deemed to consent to the third party releases based on explicit notice that the failure to vote and opt out would constitute consent to the releases).

Other courts have concluded failure to vote does not constitute consent. *See In re Chassix Holdings, Inc.*, 533 B.R. at 80-81 ("as to creditors who were entitled to vote, but who chose to take no action at all: under the circumstances of this case it would be inappropriate to treat such inaction as a "consent" to third party releases . . . implying a 'consent' to the third party releases based on the creditors' inaction, is simply not realistic or fair, and would stretch the meaning of 'consent' beyond the breaking point."); *In re Washington Mutual, Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011) ("Failing to return a ballot is not a sufficient manifestation of consent to a third party release. Therefore, the Court concludes that any third party release is effective only with respect to those who affirmatively consent to it by voting in favor of the Plan and not opting out of the third party releases.").

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## Non-debtor Releases – Majority View

Consent to Third Party Releases

*Are "opt-out" or "opt-in" provisions sufficient to create consent?*

"Opt-out" provision – Party voting in favor of or against plan would be deemed to consent to a third party release unless that party affirmatively opts against it.

> For example, in *Midway Gold*, the rejected plan's third party release provided: i) creditors who were deemed accept the plan or who were entitled to vote and did accept the plan would be deemed to have acknowledged and affirmatively consented to the third-party releases; ii) creditors who were entitled to vote and rejected the plan or who failed to submit a ballot would be deemed to have acknowledged and affirmatively consented to the third-party releases *unless* the creditor marks an appropriate box on the ballot to affirmatively opt-out of the third-party releases; or iii) creditors and equity holders not entitled to vote on the plan and are deemed to reject the plan will be deemed to have acknowledged and affirmatively consented to the third-party releases *unless* such creditor affirmatively opts-out by taking several steps to do so via the balloting agent's website. *In re Midway Gold US, Inc.*, 575 B.R. 475, 514 (Bankr. D. Colo. 2017).
>
> In *In re Indianapolis Downs, LLC*, bankruptcy court found third party releases consensual where unimpaired creditors deemed to accept the plan received consideration for the releases by being paid in full, and impaired creditors who abstained or voted to reject the plan and did not otherwise opt-out of the releases were given detailed instructions on how to opt-out and had opportunity to do so. *In re Indianapolis Downs, LLC*, 486 B.R. 286, 304-06 (Bankr. D. Del. 2013).

"Opt-in" provision – No party, even a party voting in favor of the plan, would be deemed to consent to a third party release unless that party affirmatively opts to do so, separate from that party's vote with respect to the plan.

> In *In re Chassix Holdings, Inc.*, the bankruptcy court concluded creditors consent to third party releases when they vote in favor of the plan, or reject the plan but "opted in" to the releases. However, creditors and interest holders deemed to reject the plan could not consent to the releases because they were given no opportunity to do so via an opt-in provision. Court also concluded unimpaired creditors deemed to accept the plan under 11 U.S.C. § 1126(f) should not also be deemed to have consented to the third party releases. Thus, court required plan's definition of "Consenting Creditors" to be revised to mean "(a) any Released Party, (b) any holder of a Claim who voted to accept the Plan, and (c) any holder of a Claim who voted to reject the Plan but who affirmatively elected to provide releases by checking the appropriate box on the ballot form." *In re Chassix Holdings, Inc.*, 533 B.R. 64, 82 (Bankr. S.D.N.Y. 2015). Creditors who were deemed to reject the plan were excluded from this definition because they

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## Non-debtor Releases – Minority View

*In re Western Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990)

Generally cited within this Circuit for the proposition non-debtor releases of any type are prohibited. *E.g.*, *In re Morreale Hotels, LLC*, Case No. 12-35230 TBM (Bankr. D. Colo.), Docket No. 1011 (denying plan confirmation in part because plan's exculpation provision was impermissible under binding *Western Real Estate* precedent).

Tenth Circuit, along with other minority view courts, concluded third-party releases are prohibited by 11 U.S.C. § 524(e). Further, the general equitable powers granted to bankruptcy courts by 11 U.S.C. § 105(a) do not permit a bankruptcy court to approve third-party releases to circumvent 11 U.S.C. § 524(e).

Background facts:

- Involved pre-petition litigation retainer agreement between the Chapter 11 debtor, Landsing Diversified Properties, II ("LDP"), and its former attorney, Kevin M. Abel and Abel & Busch, Inc. ("Abel"). Prior to its bankruptcy case, LDP had retained Abel to pursue litigation against Public Service Company of Oklahoma ("PSO") after two transformers maintained by PSO exploded and caused substantial damage to an LDP facility. After filing suit on behalf of LDP against PSO, Abel obtained a $3 million settlement offer and secured his contractual attorneys' fees by filing an attorneys' lien under state law.
- Subsequently, LDP filed for Chapter 11 bankruptcy and commenced an adversary proceeding against First National Bank and Trust Company of Tulsa ("FNB"), the holder of a mortgage against the damaged facility property, to determine the priority of their rights in the settlement of the suit against PSO. Abel was brought into the proceedings as a third-party defendant to resolve what rights, if any, he would have in the settlement proceeds.
- The litigation against PSO was later settled, with PSO paying LDP and FNB an amount in excess of the $3 million offer obtained by Abel, unreduced by any fee owed Abel. As part of the settlement, LDP and FNB agreed to indemnify PSO should it be held liable to Abel for any part of Abel's statutory attorney fee lien.
- Abel filed suit against PSO in state court to recover whatever portion of his fees remained unsatisfied through the debtor's bankruptcy case. The bankruptcy court permanently enjoined Abel from further prosecution, including post-confirmation, of his state court action against PSO, subject only to timely payment of Abel's diminished fee claim allowed against LDP. The bankruptcy court imposed the stay to prevent Abel from getting a second bite at the apple on his fees entitlement.

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## Non-debtor Releases – Minority View

*In re Western Real Estate Fund, Inc.*, 922 F.2d 592 (10th Cir. 1990)

The Tenth Circuit's holding:

- The Tenth Circuit found "[b]y permanently enjoining Abel's action against PSO, the bankruptcy court, in essence, discharged PSO's liability to Abel under state lien law as effectively as it discharged LDP's contractual debt to Abel under federal bankruptcy law." The Tenth Circuit found this to be improper in light of 11 U.S.C. § 524(e).
- The discharge of LDP's indemnification obligation would have occurred following confirmation of its plan and LDP would be protected by the discharge injunction under 11 U.S.C. § 524(a). This prevented PSO from seeking indemnification from LDP in the event it is liable to Abel. However, while the benefits of a discharge injunction under 11 U.S.C. § 542(a) are available to a *debtor*, under 11 U.S.C. § 524(e) the discharge "does not affect the liability of any other entity on, or the property of any other entity for such debt." The Tenth Circuit reasoned, Congress did not intend to extend the benefits of a discharge to third parties, such as PSO, who did not invoke and submit to the bankruptcy process.
- "What is important to keep in mind is that a discharge in bankruptcy does not extinguish the debt itself but merely releases the debtor from personal liability. . . . The debt still exists, however, and can be collected from any other entity that may be liable." *In re Western Real Estate Fund, Inc.*, 922 F.2d at 600.
- The Tenth Circuit found this to be consistent with 11 U.S.C. § 1141(d)(1)(A), which provides the confirmation of a plan expressly discharges the debtor – and not anyone else – from any debt arising before the date of confirmation. The Tenth Circuit also found 11 U.S.C. § 105(a) could not be used inconsistently with these provisions to impose a post-confirmation permanent injunction effectively relieving a non-debtor of its own shared liability on a debt discharged through confirmation.
- "[W]hile a temporary stay prohibiting a creditor's suit against a nondebtor . . . during the bankruptcy proceeding may be permissible to facilitate the reorganization process in accord with the broad approach to nondebtor stays under section 105(a) . . . the stay may not be extended post-confirmation in the form of a permanent injunction that effectively relieves the *nondebtor from its own liability to the creditor." *In re Western Real Estate Fund, Inc.*, 922 F.2d at 601-02. Thus, the permanent injunction issued by the bankruptcy court improperly insulated PSO from liability to Abel violation of 11 U.S.C. § 524(e).

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## Non-debtor Releases

Recent Decisions From Within the Tenth Circuit

Recently, some bankruptcy courts within this Circuit have held or recognized non-debtor releases may be permissible under certain circumstances:

- *In re Morreale Hotels, LLC*, Case No. 12-35230 TBM (Bankr. D. Colo.), Docket No. 1011: Judge Thomas B. McNamara recognized majority view allowing exculpations and third party releases under certain circumstances, but found the court was bound by restrictive Tenth Circuit precedent in *Western Real Estate*. Even if majority view was employed in that case, however, debtor failed to provide any evidence demonstrating need for non-debtor releases.
- *In re Atna Resources, Inc., et al.*, Case No. 15-22848 JGR (Bankr. D. Colo.), Docket No. 740: Judge Joseph G. Rosania's findings of fact with respect to confirmation of debtors' Chapter 11 plan found releases by holders of claims and equity interests to be appropriate under the plan. The third-party releases were very narrow and given only to the debtors, debtors' officers and directors who served during the Chapter 11 case, the committee and its individual members, a secured creditor, and each's representatives. None of the non-debtor third parties granting the releases objected to the provision.
- *In re Otero County Hospitals Assoc., Inc.*, 560 B.R. 551, 560-61 (Bankr. D. N.M. 2016): Judge Robert H. Jacobvitz held even if confirmed plan contained non-debtor releases not permitted by *Western Real Estate*, the provisions of the confirmed plan were binding and enforceable, provided all parties in interest had sufficient notice and an opportunity to object and the order confirming the plan is a final order not stayed pending appeal.
- *In re Midway Gold U.S., Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017): Judge Michael E. Romero concluded *Western Real Estate*'s bar on third-party releases is not as broad as generally argued and applied, and followed majority view 11 U.S.C. § 524(e) did not categorically preclude such releases. Under *Western Real Estate*, the plan could not release the non-debtor from its own shared liability in violation of 11 U.S.C. § 524(e). The Court found the provision at issue did not violate 11 U.S.C. § 524(e) because it would only bar the non-debtor releasing parties from pursuing claims against the non-debtor released parties for which neither the debtor nor the estate would have any liability. However, Court could not conclude, based on the release provision as written, it had jurisdiction to enjoin the claims through confirmation of the plan.

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## Non-debtor Releases – Minority View

*In re Midway Gold U.S., Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017)

Although *Western Real Estate* remains binding precedent on all courts within this Circuit, Judge Romero concluded the bar on third-party releases imposed by *Western Real Estate* is not as broad as previously applied. Rather, *Western Real Estate* is limited in scope to those cases where a Chapter 11 plan provides, contrary to 11 U.S.C. § 524(e), for the release of or injunction on claims against a non-debtor, such as a co-debtor or a guarantor, with respect to an obligation jointly owed with the debtor where the non-debtor has not submitted itself to the bankruptcy process.

11 U.S.C. § 524(e) provides:

> "Except 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."

Under 11 U.S.C. § 524(e), even if a debt is discharged as to the debtor in a Chapter 11 plan, a creditor can still seek to collect that debt from a non-filing co-debtor, guarantor or obligor. Consistent with *Western Real Estate*, confirmation of a plan cannot serve to bar litigation against non-debtors for the remainder of the discharged debt. Further, a bankruptcy court may not use 11 U.S.C. § 105(a) inconsistently with 11 U.S.C. § 524(e) to effectively relieve a non-debtor of its shared obligation on a discharged debt.

However, "such debt" as used in 11 U.S.C. § 524(e) refers to the "debt of the debtor" being discharged. 11 U.S.C. § 524(e) does not refer to non-debtors' independent obligations not subject to the discharge. Thus, 11 U.S.C. § 524(e), and *Western Real Estate*, does not expressly bar the bankruptcy court from approving non-debtor third party releases.

Judge Romero concluded interpretation is consistent with, and fully respects, the holding in *Western Real Estate*.

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## Non-debtor Releases – Minority View

*In re Midway Gold U.S., Inc.*, 575 B.R. 475 (Bankr. D. Colo. 2017)

Judge Romero held 11 U.S.C. § 105(a) permits bankruptcy courts to release third parties from liability in certain, and very limited, circumstances if the release is "appropriate" and not inconsistent with any other provision of the Bankruptcy Code, including 11 U.S.C. § 524(e). The court did not adopt a specific test for determining permissibility of third-party releases, but was guided by several non-exclusive principles:

(1) Whether a release is appropriate and permissible should be determined on a case-by-case basis.

(2) The Court must parse out exactly who is releasing whom from what. It is appropriate for the Court's analysis to distinguish between the Debtors' release of non-debtors and third-parties' release of non-debtors.

(3) The Court must also find the release to be necessary for the reorganization and appropriately tailored to apply only to claims arising out of or in connection with the reorganization itself, and not to matters which would have no effect upon the estate. Otherwise, the releases in question may be beyond the jurisdiction of the bankruptcy court and its authority to finally adjudicate such matters.

(4) The Court must also examine whether the releasing creditors have consented to or objected to the proposed injunctions.

(5) Lastly, the releases may not provide nondebtors with "blanket immunity" for all times, transgressions and omissions and may not include immunity from gross negligence or willful misconduct.

(6) For the Court to have jurisdiction over claims between non-debtor third parties, the releases must at least be such that the disputes subject to releases or injunctions would have an effect, on the debtor's property or the administration of the debtor's bankruptcy estate. Otherwise, there would not be the "identity of interests" between the debtor and the released parties required under both the *Master Mortgage* and *Dow Corning* tests. The possibility of contribution or indemnification claims by third parties may support an exercise of "related to" jurisdiction by the Court.

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## Analyzing Chapter 11 Plan Releases

*Nuts and Bolts of Evaluating Third-Party Releases in Chapter 11 Plans*, Jason W. Bank, American Bankruptcy Institute Journal, September 2018.

*Who? What? When? Where? How?*

***Who are the parties giving the releases?***

Does releasing party have capacity/standing to grant the release?

Different standards apply to releases by debtors and non-debtors, and must be separately analyzed.

***Who are the parties being released?***

Is the person or entity entitled to a release? Is the released party entitled to exculpation based on qualified immunity for actions taking during Chapter 11 case?

Have released parties contributed to the reorganization or were they necessary to the reorganization?

***What is the scope and nature of the claims are being released?***

Are the provisions narrowly tailored to release only what is permissible? Does release violate 11 U.S.C. § 524(e)?

Universe of claims being released cannot be limitless. Releases or exculpations for acts and omissions unrelated to reorganization likely impermissible (*e.g.*, liability for passerby slip and fall on debtor's property during Chapter 11 case).

***When/What time periods apply to the releases?***

Are claims and defenses prior to the petition date being released? Prior to the effective date of a plan? Release of post-confirmation claims and defenses?

***Where?***

Many of the answers to these questions can be found in the plan's defined terms. Defined terms should be carefully scrutinized to determine if releases are permissible.

***How are the releases being effected?***

Is there consent by non-debtor third parties releasing claims under the plan? Does plan contain an opt-out provision?

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# CREATIVE WAYS TO TREAT RECALCITRANT CREDITOR

**R. Kimball Mosier**
**Chief Bankruptcy Judge, District of Utah**

If you anticipate at least one rejecting creditor you will need to change their mind to vote in favor of the plan or obtain confirmation without their acceptance and over their possible objection to confirmation.

## I. Determine the accepting impaired class or classes.

You need at least one impaired class (or none).

A. Impaired accepting unsecured class or classes.

B. Impaired accepting secured class or classes.

## II. Determine the rejecting creditors/classes and whether their acceptance is necessary for plan confirmation.

A. Rejecting secured class or classes.

B. Rejecting unsecured class or classes.

Determine whether the rejecting class is controlled by a rejecting creditor or group of creditors. Rejecting creditors/classes may be less important if confirmation can be obtained without their consent. If the rejecting creditors do not control the class, then there should be less concern about their vote.

## III. Determine the Creditors motivation.

A. Is the creditor voting its "creditor" or economic interest?

B. Is the creditor voting a "non-creditor" interest?

Determining the creditor's motivation is important to resolving their objection. If the creditor is voting its "creditor (economic) interest" then resolution would typically be resolved by convincing the creditor that the plan is the best alternative for recovering the greatest amount of its claim.

## IV. Treating secured creditors voting their "creditor" interest.

A. Negotiate. Attempt to arrive at a plan the creditor will accept.

1. Compromise a legitimate challenge to secured interest?

B. Return collateral. This may raise an issue with respect to unsecured claim classification.

C. Convince the court the secured creditor is not impaired and therefore not entitled to vote on the plan. The relevant code provision is 11 U.S.C. § 1124.

**11 U.S.C. § 1124 Impairment of claims on interests**

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—

(1)leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

(A)cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C)compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;

(D)if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor in an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and

(E)does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.

Impairment is any treatment, other than treatment as provided by §1124(1) and (2). "A claim is to be quantified "as of the date of the filing of the petition." Code § 502(b). Thus, if a creditor receives under a plan everything to which the creditor would be entitled in a judgment entered immediately following the plan's effective date, the creditor is receiving treatment that, as required by §1124(1), honors all the creditor's "legal, equitable, and contractual rights." For the typical unsecured creditor, those rights equate to payment of the debt owed with interest as allowed by law." *In re Texas Rangers Baseball Partners*, 434 B.R. 393, 406 (Bankr. N.D. Texas 2010). "[T]he fact that congress provided in §1124(2) that unimpaired treatment must include cure of most defaults but did not do so in §1124(1) indicates that the intent of legislators was that unimpaired treatment under the latter provision would include, once that treatment became effective, allowing the class so treated to pursue remedies not otherwise in conflict with the Code, the plan or bankruptcy court orders for defaults existing as of the effective date." *Id.* at 409.

D. Cram down. Cramdown of secured claims is provided for in 11 U.S.C. § 1129(b)(2)(A).

**11 U.S.C. § 1129 Confirmation of plan**

. . .

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)

(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

"A chapter 11 plan proposed over the objection of a class of secured claims must meet one of three requirements in order to be deemed "fair and equitable," and therefore confirmable. The secured creditor may retain its lien on the property and receive deferred cash payment, § 1129(b)(2)(A)(i); the debtors may sell the property free and clear of the lien, "subject to section 363(k)" - which permits the creditor to credit-bid at the sale and provide the creditor with a lien on the sale proceeds, § 1129(b)(2)(A)(ii); or the plan may provide the secured creditor with the "indubitable equivalent" of its claims, § 1129(b)(2)(A)(iii). A chapter 11 plan that proposes to sell property under § 1129(b)(2)(A) but deny a creditor secured to the property the right to credit bid by arguing that creditor is, instead, receiving the indubitable equivalent cannot be confirmed." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065 (2012).

**V. Treating secured creditors voting their "non-creditor" interest.**

Because secured creditors are typically separately classified, the treatment of secured creditors voting their "non-creditor" interest will probably be the same as secured creditors voting their "creditor interest."

A. Negotiate.

1. Compromise a legitimate challenge to secured interest?
2. Return collateral. (this may raise issue with unsecured classes)

B. Convince the court the secured creditor is not impaired.

C. Cram down.

**VI. Treating unsecured creditors voting their "creditor" interest.**

A. Determine whether the creditor control the class. If the creditor will not control the class (i.e. imped the requisite majority) then the creditor can be ignored.

B. Negotiate. Reach an agreement the provides the creditor the highest likelihood of recovery.

**VI. Treating unsecured creditors voting their "non-creditor" interest.**

A. Determine whether the creditor(s) will control the unsecured class. If the creditor(s) do not control the class then there is less concern.

B. Negotiate.

C. Separate classification and cram down.

If you cannot obtain acceptance by the class because the class is controlled by a creditor(s), consider whether a legitimate separate classification of the rejecting creditor(s) will create an accepting class. Separate classification may be permitted under 11 U.S.C. §1122.

> **11 U.S.C. § 1122 Classification of claims or interests**
>
> (a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.
>
> (b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

Debtor's are entitled to flexibility in classifying claims into different classes so long as a rational, legal, or factual basis for separate classification exists and all claims or interests within a particular class are substantially similar. *In re Nuverra Environmental Solutions, Inc.*, 2018 WL 3991471 (D. Delaware 2018). "The one clear rule is that separate classification cannot be used for the purposes of obtaining an accepting class. But, if there is a reasonable or justifiable basis for separate classification, the fact that separate classification creates an accepting class is not a bar to separate classification." *Minerals Techs., Inc. v. Novinda Corp. (In re Novinda Corp.)*, 585 B.R. 145, 158 (10th Cir. BAP 2018).

Classification and unfair discrimination are separate issues. A debtor does not need to address fairness or unfair discrimination for classification purposes. But, once a debtor separately classifies claims, it must still address the fairness and discrimination issues that may arise from treatment of the separately classified claims. Separately classified unsecured creditors who reject the plan will probably object to confirmation on both grounds. The plan cannot "discriminate unfairly" and must be fair and equitable with respect to the creditor's class of claims. 11 U.S.C. §1129(b)(1). Cramdown of unsecured claims is provided for in 11 U.S.C. § 1129(b)(2)(B).

> **11 U.S.C. § 1129 Confirmation of plan**
>
> . . .
>
> (b)
>
> (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm

the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(B) With respect to a class of unsecured claims—

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

Unfair discrimination is more than simply making a distinction between claims. As a general rule, the unfair discrimination standard ensures that a dissenting *class* will receive relative value equal to the value given to all other similarly situated *classes*. Several courts have adopted a test that creates a rebuttable presumption of unfair discrimination when there is: (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution. *Minerals Techs., Inc. v. Novinda Corp. (In re Novinda Corp.)*, 585 B.R. 145, 159 (10th Cir. BAP 2018).

D. Convince the court the unsecured creditor(s) is not impaired and therefore not entitled to vote on the plan. 11 U.S.C. §1124. If a creditor receives under a plan everything to which the creditor would be entitled in a judgment entered immediately following the plan's effective date, the creditor is receiving treatment that, as required by §1124(1), honors all the creditor's "legal, equitable, and contractual rights." For the typical unsecured creditor, those rights equate to payment of the debt owed with interest as allowed by law." *In re Texas Rangers Baseball Partners*, 434 B.R. 393, 406 (Bankr. N.D. Texas 2010).