AMERICAN BANKRUPTCY INSTITUTE

2019 Mid-Atlantic Bankruptcy Workshop

Bankruptcy Trends: Contracts and Plans

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CONCURRENT SESSION

2019

Contracts & Plans

How Bankruptcy & Contracts Collide

2019 Mid-Atlantic Bankruptcy Workshop

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Third-Party Releases

General Overview

- Provisions in a plan that release or limit the liability of non-debtor parties to other non-debtor parties, enjoining future litigation against the released parties for their pre-confirmation actions.
- Becoming increasingly common
  - Code only *specifically* provides for third-party releases in connection with asbestos liability (§524(g))
- Consensual vs. nonconsensual
  - Courts generally agree that third-party releases are permissible to the extent that creditors consent to the release.
- Split in Circuits re whether nonconsensual third-party releases are allowed
  - Third Circuit allows nonconsensual third-party releases *if the releases are fair and necessary* to the debtor's reorganization, and there are specific factual findings supporting this conclusion. *In re Cont'l Airlines*, 203 F.3d 203, 214 (3d Cir. 2000)
  - First, Second, Fourth, Sixth, Seventh, Eleventh, and D.C. Circuits also allow it;
  - Fifth, Ninth and Tenth Circuits do not.
- In *Continental*, Third Circuit found that there was no evidence in the case that the releases were fair or necessary to the reorganization
- Since *Continental*, numerous courts in the Third Circuit have approved plans containing nonconsensual third-party releases.
  - *Continental* decision has been reaffirmed by Third Circuit, including in In re Glob. Indus. Techs., Inc., 645 F.3d 201, 206 (3d Cir. 2011) and In re Lower Bucks Hosp., 571 F. App'x 139, 144 (3d Cir. 2014)

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Bankruptcy Court Jurisdiction

- *In re Millennium Lab Holdings II, LLC*, 591 B.R. 559 (D. Del. 2018)
  - District Court affirmed Bankruptcy Court holding that Bankruptcy Court has **constitutional authority** to approve third-party releases.
  - Bankruptcy Court had found that it had **core jurisdiction** to decide whether to a approve a plan containing third-party releases.
  - This case is on appeal to the Third Circuit, and has been fully briefed.
- *In re Kirwan Offices S.a.r.l.*, 592 B.R. 489 (S.D.N.Y. 2018)
  - A bankruptcy court acts pursuant to its **core jurisdiction** when it considers the involuntary release of claims against a third-party non-debtor in connection with plan confirmation.
- *In re CJ Holding Co.*, 597 B.R. 597 (S.D. Tex. Feb. 8, 2019)
  - Bankruptcy court had "**related to**" jurisdiction over plan containing third-party releases.
- *In re Aegean Marine Petroleum Network Inc.*, No. 18-13374 (MEW), 2019 WL 1527968 (Bankr. S.D.N.Y. Apr. 8, 2019)
  - Court **lacked in rem jurisdiction** to determine anything regarding potential third-party claims, even if this issue was being decided in the context of confirmation.
  - Problematic that potential third-party claimants were not, and could not, be afforded proper notice.

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Does Creditors' Silence = Consent?

- Split in Delaware
- *In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013)
  - third-party releases consensual where creditors failed to opt out of the releases, either by abstaining from voting or by voting against the plan but not otherwise opting out of the releases
- *In re Rand Logistics, Inc., et al.*, No. 18-10175 (Bankr. D. Del. 2018) (Dkt. No. 156)
  - Under the plan, the third-party releases were provided by (i) holders of claims voting to accept the plan, (ii) holders of unimpaired claims and (iii) holders of claims entitled to vote that did not submit a ballot and timely object to the releases. Bankruptcy Court found that these third-party releases were consensual.
- In re Washington Mut., Inc., 442 B.R. 314, 355 (Bankr. D. Del. 2011)
  - "[f]ailure to return a ballot is not a sufficient manifestation of consent to a third party release"
  - only those creditors who affirmatively consented by voting in favor of the plan and not opting out of the releases were bound by the release

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Does Creditors' Silence = Consent?

- Other Case Law
- *In re CJ Holding Co.*, 597 B.R. 597 (S.D. Tex. Feb. 8, 2019)
  - The claimant was bound by the release provisions despite not voting on, or objecting to, the plan on the theory that the claimant's "silence" should be "construe[ed] . . . as consent".
- *In re SunEdison, Inc.*, 576 B.R. 453 (Bankr. S.D.N.Y. 2017)
  - Held that a warning in a disclosure statement indicating that the failure to object is "deemed consent" to third-party releases was insufficient to turn a creditor into a consenting creditor.

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Plan Provisions With Third-Party Releases

- *In re Millennium Lab Holdings II, LLC*, 15-12284 (LSS) (Bankr. D. Del. Dec. 14, 2015) (Dkt. No. 195)
  - nonconsensual third party releases were both fair and necessary to reorganization
- *In re Aegean Marine Petroleum Network Inc.*, No. 18-13374 (MEW), 2019 WL 1527968 (Bankr. S.D.N.Y. Apr. 8, 2019)
  - Confirmed the Plan, but stripped the proposed broad non-consensual releases.
  - Problematic that parties could not identify specific claims that they believe must be barred in order to enable the reorganization:
    - "I am left with the suggestion that nobody can really think of anything, or certainly not anything that they think would have merit, but that it is nevertheless somehow important to this reorganization for me to impose a broad third-party release. In substance, this amounts to a suggestion that I should give releases unless I can come up with a good reason not to do so."
    - "third-party releases are not a merit badge that somebody gets in return for making a positive contribution in restructuring. They are not a participation trophy, and they are not a gold star for doing a good job."
- *In re Specialty Retail Shops Holding Corp., et al.*, No. 19-80064 (TLS) (Bankr. D. Neb. May 29, 2019) (Dkt. No. 1480)
  - Denied confirmation of a proposed plan due to the plan's expansive non-consensual third-party releases.

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Plan Trends:
Combined Plan & Disclosure Statement Approvals

Streamlining D/S & Plan Process

Feb 2016

- U. S. Bankruptcy Court for the District of Delaware enacted Local Rule 3017-2
  - provides mechanism for streamlining the disclosure statement and plan approval process in liquidating Chapter 11 cases.

Before:

- Delaware Bankruptcy Court had permitted the use of combined hearings in a handful of non-prepackaged, non-small business liquidating Chapter 11 cases.
- In each instance, combined process was sought to reduce the administrative burn following sales of substantially all of the debtors' assets.

After:

- Numerous cases have taken advantage of the rule seeking a combined hearing on the approval of the disclosure statement on a final basis and confirmation of the plan of liquidation.

Streamlining D/S & Plan Process

- To qualify under Local Rule 3017-2, the following requirements must be met:
  1. all or substantially all of the assets of the debtor were or will be liquidated pursuant to a 363 sale;
  2. the plan of liquidation proposes to comply with Bankruptcy Code section 1129(a)(9);
  3. the plan may not seek *non-consensual* releases/injunctions with respect to claims creditors may hold against non-debtor parties; and
  4. the debtor's combined assets to be distributed pursuant to the proposed plan of liquidation are estimated, in good faith, to be worth less than $25 million (excluding causes of action).
- Requirements 1, 2 and 4 are boxes easily checked.
- Questions arise though on whether the releases sought are consensual or not.

Streamlining D/S & Plan Process

- Things to Consider When Deciding Whether to Proceed under Local Rule 3017-2.
  - If consensus can be reached among the various case constituencies, the use of this streamlined process likely can save the estates significant time and money.
  - However, if a party contests, and ultimately prevails in challenging , for example the adequacy of the disclosure statement at the combined hearing, anticipated time and money savings evaporate. And, the debtor will find itself back at square one.
- Some question whether this process (as opposed to the traditional, separate disclosure statement and plan process) actually saves time and, in return, the administrative costs over the lifetime of the case.

Liquidating Trust Agreements

Liquidating Trust Agreements

Structure

- Strong Trustee, weak oversight vs Strong oversight, weak Trustee

Preserving Claims

- Closely monitor plan releases
- Ensure adequate disclosure of claims in Plan and Disclosure Statement to satisfy 1123(b)(3)(B)
- Ensure Liquidating Trust Agreement clearly and explicitly assigns all claims of any nature to the Trustee
- Follow applicable state law concerning assignment of tort claims
- How causes of action are vested can impact what causes survive

Liquidating Trust Agreements

Tax Considerations

- To avoid double taxation, liquidating trust agreement must meet IRC requirements to be a "grantor trust" under Treas. Reg. §301.7701-4(d)
- Trust must be organized for the primary purpose of liquidating and distributing the assets transferred to it
- If liquidation is unreasonably prolonged or obscured by other business activities tax status may be revoked

Liquidating Trust Agreements

Tax Considerations (continued)

- Trust must be created pursuant to confirmed plan for the primary purpose of liquidating the assets transferred to it
- Plan and DS must explain how the estate will treat the transfer for tax purposes
- Beneficiaries must be treated as grantors and deemed owners of the trust
- Trustee must file tax returns and all trust income must be taxed on a current basis
- Trust instrument must contain fixed or determinable termination date that is generally not more than 5 years from creation – can be extended
- Investment powers of Trustee must be limited to demand and time deposits
- Trust must make distributions at least annually