AMERICAN BANKRUPTCY INSTITUTE

2018 Mid-Atlantic Bankruptcy Workshop

Deconstructing the Order, Part II: Confirmation

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CONCURRENT SESSION

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Overview of Panel

Examples of issues that create frustration for bankruptcy judges through inconsistent or vague language, misinterpretation or fundamental flaws

Potential Issues in Confirmation Orders

I. Length/Breadth of Confirmation Order
II. Inconsistent Carve-Out Language
III. Automatic Disallowance of Late Claims
IV. Reorganized Debtor Plus Litigation Trust
V. Continuation of the Automatic Stay
VI. Powers of Liquidating Trusts: Derivative Claims
VII. Extension of Attorney-Client Privilege
VIII. Which Plan Document Controls in the Event of Inconsistencies?
IX. Closure of Cases
X. Unintended Releases
XI. Retention of Jurisdiction
XII. Injunction Against Plan Interference

Length/Breadth of Confirmation Orders

- Confirmation orders are routinely over 50 pages long. How long is too long?

Inconsistent Carve-Out Language

- "Notwithstanding anything to the contrary in the Plan..."

Automatic Disallowance of Late Claims

- Can the confirmation order provide that late-filed claims are automatically disallowed?

Reorganized Debtor Plus Litigation Trust

- Ambiguities may arise when a plan provides for the reorganization of the debtor, as well as the creation of a litigation trust.

Continuation of the Automatic Stay

- Can a confirmation order provide that the automatic stay extends past the effective date?

Powers of Liquidating Trusts: Derivative Claims

- Understanding injunction provisions in relation to release language.

Which Plan Document Controls in the Event of Inconsistency?

- Does the confirmation order, plan or liquidating trust agreement control in the event of inconsistencies?

Extension of Attorney-Client Privilege

- Should the confirmation order include an explicit provision extending a debtor's right to assert or waive attorney-client privilege to a third party (i.e., purchaser in a plan sale or a liquidating trust) with derivative standing to sue on behalf of the debtor?

Closure of Cases

- Can confirmation orders contain provisions authorizing the closure of chapter 11 cases upon the effective date, without the need for debtors to file a motion for approval to close the cases?

Unintended Releases

- Can confirmation orders include language that provides a broader discharge or release than what is contained in the Plan? Or can a confirmation order (and related findings at the confirmation hearing by the Judge) limit the release language contained in the Plan?

Retention of Jurisdiction

- When is the scope of the retention of jurisdiction language in a confirmation order too broad?

Injunctions Against Plan Interference

- How often do you have a plan injunction in a liquidating case that becomes a discharge because of the way it is worded?

Common Pet Peeves in Confirmation Orders

I. Rewriting the Bankruptcy Code
II. Restating the Plan
III. Unnecessary Comfort Language
IV. Conflicts with Federal or State Law
V. Effect of the Confirmation Order in Relation to Non-Bankruptcy Law
VI. References to the Accuracy of Financial Projections
VII. Broad Statements
VIII. Last Minute Additions

Rewriting the Bankruptcy Code

- Language in confirmation order should track the language of the Code. Judges often raise objections when a confirmation order includes language rewriting sections of the Code.

Restating the Plan

- Another issue that creates frustration is the restatement of entire sections of the Plan in the confirmation order. This often leads to longer than necessary forms of order.

Unnecessary Comfort Language

- The addition of unnecessary comfort language contributes to the unwieldly length of confirmation orders.

Conflicts with Federal or State law

- Proposed order includes language that the documents necessary to implement the plan are not in conflict with applicable law; judge cannot confirm this is true so the language is often stricken.

Effect of the confirmation order in relation to non-bankruptcy law

- Provisions providing that the confirmation order and plan shall apply notwithstanding otherwise applicable non-bankruptcy law are often amended to include "to the extent permitted by the Bankruptcy Code."

References to the Accuracy of Financial Projections

- Judge has no way of knowing whether or not the liquidation analysis and financial projections are accurate, so references to the accuracy of those analyses are often stricken.

Broad Statements

- Broad statements included in confirmation orders are often problematic.

Last Minute Additions

- Last minute additions to the confirmation order can create havoc.

An Overview of the Current State of the Law on Third-Party Releases in Delaware

Written Materials for Panel at the 2018 ABI Mid-Atlantic Bankruptcy Workshop

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I. INTRODUCTION AND OVERVIEW

A proposed Chapter 11 plan may include settlements that release third parties, meaning the plan provisions require the court to enjoin litigation against the released parties for pre-confirmation actions.[1] Third-party releases breed litigation because they invoke two competing bankruptcy provisions.[2] While section 105(a) of title 11 of the Unites States Code (the "Bankruptcy Code") states that "a court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," section 524(e) sates that "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."[3] The United States Bankruptcy Court for the District of Delaware (the "Delaware Bankruptcy Court") follows the majority approach to resolving this conflict: interpret section 524(e) narrowly and allow courts to exercise their section 105(a) equitable powers to grant third-party releases when doing so is necessary to carry out the Chapter 11 plan.

There are two situations in which a plan may provide for release of a third party: 1) where a debtor releases the third party and 2) where a non-debtor (i.e. a creditor) releases a third party.[4] The type of third-party release in question determines the court's mode of analysis.[5]

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1 *See generally* "Releasing Non-Debtors Through a Chapter 11 Plan of Reorganization," *American Bankruptcy Institute* (Dec./Jan. 2000).

2 "Third-Party Releases in Bankruptcy Plans," *Practical Law Practice*, Note 3-570-7925 at 4-5.

3 11 U.S.C. § 105(a) (2010); id. § 524(e).

4 *See generally* "Third-Party Releases in Bankruptcy Plans."

5 *See generally id.*

Further, whether the release is consensual or non-consensual is also critical to the court's analysis.[6]

II. DETERMINING CONSENT

The Delaware Bankruptcy Court holds that consensual third-party releases are permissible to the extent they bind creditors who consented to the release, regardless of whether a debtor or creditor is the releasing party.[7] What constitutes consent is less clear.[8] The Delaware Bankruptcy Court has held that creditors voting in favor of a plan that contains a third-party release have consented to such a release.[9] Additionally, the court has sometimes ruled that a creditor consents to a third-party release when failing to return a ballot that contains an opt-out provision; such a creditor seemingly acquiesces in the release.[10] The Delaware Bankruptcy Court, however, is inconsistent as to whether failing to affirmatively opt out of the release equals consent.[11] In *In re Indianapolis Downs, LLC*, the court upheld third-party releases where creditors failed to opt out of the releases when they abstained from the vote, and thus failed to select the opt-out provision.[12] Further, the court treated creditors as consenting parties when they objected to the plan but did not affirmatively select the opt-out provision.[13] The *In re*

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6 *See generally id.*

7 *Id*. at 7.

8 *Id*.

9 *See In re Washington Mutual, Inc.*, 42 B.R. at 355.

10 *See In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013).

11 *Compare id.* at 306 (attributing consent to those who failed to affirmatively opt out), *with In re Washington Mutual, Inc.*, 42 B.R. at 354 ("Failing to return a ballot is not a sufficient manifestation of consent to a third party release.") (internal citation omitted).

12 *See In re Indianapolis Downs, LLC*, 486 B.R. at 305 (upholding plan that "provides that those who fail to opt out, or to vote, are 'deemed' to consent to the Third-Party Release.").

13 *See id.*

Indianapolis Downs, LLC, approach stands in contrast with the court's decision three years prior in *In re Washington Mutual, Inc.*, wherein the Delaware Bankruptcy Court required affirmative consent from creditors with regards to a third-party release in order to deem the release consensual.[14] The court held, "Failing to return a ballot is not a sufficient manifestation to consent to a [third-party] release…."[15] While *In re Indianapolis Downs, LLC*, is the more recent case, the court did not overrule the *In re Washington Mutual, Inc.*, approach that was more hesitant to find consent.[16] Therefore, a creditor who affirmatively votes for a release will be a consenting creditor, but it is unclear whether a creditor who fails to submit a ballot, or a creditor who objects to the plan but fails to select the opt-out provision, is a consenting creditor.[17]

III. CONSENSUAL THIRD-PARTY RELEASES

If the court determines that a third-party release is consensual after considering the factors discussed above, the release will generally be permissible as to the creditors who accepted the terms of the plan containing the release provision.[18] This applies to both types of third-party releases: those in which the debtor is the releasing party and those in which a creditor is the releasing party.

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14 *See In re Washington Mutual, Inc.*, 42 B.R. at 355.

15 *Id.* at 354.

16 *See In re Indianapolis Downs, LLC*, 486 B.R. at 305 (distinguishing opt-out clause in *Washington Mutual* because the clause in that case mandated third party releases even if an objecting party indicated on the ballot that it did not wish to grant the release).

17 *Compare id.* at 306, *with In re Washington Mutual, Inc.*, 42 B.R. at 354.

18 *See id.* at 75 ("Because [the release] is consensual, there is no need to consider the *Zenith* factors.").

IV. NON-CONSENSUAL THIRD-PARTY RELEASES

Conversely, the Delaware Bankruptcy Court has held that non-consensual releases are permissible only in "extraordinary" cases. This inquiry typically involves a judge's fact-specific balancing of the equities of the non-consensual release. Ultimately, a court will only uphold the non-consensual release if the released third parties provided a substantial contribution as consideration for the release.[19] Furthermore, whether a debtor or creditor is the releasing party directs the court's analysis.

A. Non-Consensual Debtor Releases of Third-Parties

The permissibility of a debtor's non-consensual release of a third party requires a fact-intensive inquiry.[20] If a court finds a debtor's release of a third party is non-consensual as to impacted creditors, the court will apply a five-factor test from *In re Zenith Electronics Corp.* The *Zenith* five-factor test considers "(1) the identity of interest between the debtor and the third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) substantial contribution by the non-debtor of assets to the reorganization; (3) the essential nature of the injunction to the reorganization to the extent that, without the injunction, there is little likelihood of success; (4) an agreement by a substantial majority of creditors to support the injunction, specifically if the impacted class or classes 'overwhelmingly' votes to accept the plan; and (5) provision in the plan for payment of all or substantially all of the claims of the class or classes affected by the injunction."[21] The *Zenith* test

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[19] *See In re Exide Technologies*, 303 B.R. 48, 75 (Bankr. D. Del. 2003) (rejecting non-consensual release because releasing party did not provide consideration to unsecured creditors in exchange for release).

[20] *See In re Tribune Co.*, 464 B.R. 126, 185 (Bankr. D. Del. 2011) ("Determining the fairness of a plan which includes the release of non-debtors requires the consideration of numerous factors and the conclusion is often dictated by the specific facts of the case.") (internal citations omitted).

[21] *Id.*

provides guidance to courts when weighing the equities of a release, but "these factors are neither exclusive nor are they a list of conjunctive requirements."[22]

i. Identity of Interest

The identity of interest factor requires "an identity of interest between the debtor and third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate."[23] The most common way the Delaware Bankruptcy Court finds the requisite identity of interest is by looking to whether the debtor has a contractual obligation to indemnify the third-party.[24] Additionally, "interlocking and competing claims" of debtors and third parties to various assets may constitute a unity of interest.[25] Finally, the Delaware Bankruptcy Court has even found that a "common goal of achieving reorganization of the [d]ebtors" to be suggestive of a unity of interest, even when the debtor and third-party lack a shared identity with regards to litigation.[26]

ii. Substantial Contribution

A third-party's significant monetary contribution to the reorganization often satisfies the substantial contribution requirement.[27] Further, waiver of claims may also constitute a third

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22 *Id.*

23 *In re Zenith Electronics Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999).

24 *See In re Indianapolis Downs, LLC*, 486 B.R. at 303 ("The record reflects that the Debtors' organizational documents require the Debtors to indemnify the Oliver Releasees and each of the Oliver Releasees has asserted indemnification claims against the Debtors' estates. Therefore, the first *Zenith* factor is satisfied with respect to the Oliver Releases.").

25 *See In re Washington Mutual, Inc.*, 42 B.R. at 347 (finding "interlocking and competing claims" sufficient to satisfy the *Zenith* unity of interest prong).

26 *See In re Tribune Co.*, 464 B.R. at 187 (giving weight to the fact debtors and settling parties had a common goal of confirming and implementing the plan, which included the releases).

27 *See In re Coram Health Corp.*, 315 B.R. 321, 331 (Bankr. D. Del. 2004) (finding contribution of $56 million to be substantial contribution).

party's substantial contribution to the plan if the waiver significantly reduces the claims against the estate and promotes the continued use of property of the estate.[28] A third party's continued services for a debtor, post-petition and without receiving compensation, may also constitute a substantial contribution.[29] Conversely, the Delaware Bankruptcy Court has found that a third party has *not* made a substantial contribution to the plan by merely setting aside a fund for the benefit of general unsecured creditors in an attempt to gain a release.[30]

iii. Necessity of Release to Reorganization

The court may deem a release as a necessity to reorganization if the third party provided a substantial contribution to the plan that the third party would not have made but-for the desired release.[31] A release is also a necessity to reorganization when the reorganization plan would not be administrable without the release's corresponding settlement due to the complexity of the relationship between the debtor and third party.[32]

iv. Creditors' and Interest Holders' Overwhelming Acceptance

Whether creditors and interest holders overwhelmingly accept the release requires looking to whether such parties voted to approve the proposed plan. While the Delaware Bankruptcy Court has not established a threshold or otherwise defined "overwhelming" within

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28 *See In re Washington Mutual, Inc.*, 42 B.R. at 347 (determining waiver of claims was sufficient consideration, especially because such waiver saved the estate money and allowed it to continue freely using property).

29 *See In re Indianapolis Downs, LLC*, 486 B.R. at 302 (explaining second *Zenith* factor satisfied where released party continued rendering services without compensation).

30 *See In re Exide Technologies*, 303 B.R. at 74 (describing insufficient contribution).

31 *See In re Flintkote Co.*, 2015 WL 4762580, Case No. 04-11300 (MFW) 1, at *10 (Bankr. D. Del. 2015) (holding that the release was a necessity to reorganization because the releasing party would not have agreed to the underlying settlement, which was integral to the plan, without inclusion of the release).

32 *See In re Washington Mutual, Inc.*, 42 B.R. at 347 (finding release to be necessary because it was "hard to imagine" devising a plan without them due to the complexity of the potential claims).

this context, it has found that 99% and 94% votes for approval are sufficient.[33] The "overwhelming acceptance" inquiry is likely to be both fact and case specific.

v. Payment of Creditor or Interest Holder Claims

The Delaware Bankruptcy Court has found that a release will allow "all or substantially all" creditors and interest holders to receive payment when all but "the lowest subordinated class…will receive payment in full plus post-petition interest from the proceeds of the assets released by the Global Settlement."[34] Conversely, the court is unlikely to uphold a release when the plan provides for "only a minimal payment of claims of the class affected by the [release]."[35]

B. NON-CONSENSUAL CREDITOR RELEASES OF THIRD-PARTIES

The Delaware Bankruptcy Court grants non-consensual creditor releases of third parties "only in extraordinary cases."[36] While the court applies *Zenith* and its progeny to debtor releases of third parties, it applies a different fairness analysis to non-consensual creditor releases of third parties.[37] Neither the Third Circuit nor the Delaware Bankruptcy Court have established a bright-line rule regarding these types of releases; instead, courts within the Third Circuit normally weigh the "hallmarks" of a permissible non-consensual creditor release of a third party: "fairness, necessity to the reorganization, and specific factual findings to support these

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33 *See In re Flintkote Co.*, 2015 WL 4762580 at *10 (explaining overwhelming acceptance).

34 *See In re Washington Mutual, Inc.*, 42 B.R. at 348 (finding all or substantially all prong satisfied, with total payment being $7.5 billion).

35 *In re Exide Technologies*, 303 B.R. at 74.

36 *See In the Matter of Genesis Health Ventures, Inc.*, 266 B.R. at 608 (asserting that non-consensual releases are acceptable only in extraordinary cases).

37 *See In re Spansion, Inc.*, 426 B.R. 114, 142-44 (Bankr. D. Del. 2010) (applying *Zenith* to debtor releases and *Continental* and *Genesis* to creditor releases).

conclusions…."[38] Moreover, courts require "adequate consideration to a claimholder being forced to release claims against non-debtors" before finding that the third-party release is permissible.[39]

The Delaware Bankruptcy Court has set a high threshold for finding the fairness and necessity requisite to a permissible creditor release of a third party. In *In re Spansion, Inc.*, for example, the parties to be released provided significant contributions to the plan, including significant amounts of time and money, and moreover, the plan stood to fully pay secured creditors while providing significant value to unsecured creditors.[40] Nevertheless, the Delaware Bankruptcy Court applied precedent from the Third Circuit Court of Appeals and held, "While…Debtor Releasees undertook substantial (and certainly sometimes exhausting) efforts to formulate and negotiate the current…Plans…those contributions [do not] rise to the level of the critical financial contribution contemplated in *Continental* and *Genesis* that is needed to obtain approval of non-consensual releases."[41] In *In re Continental Airlines,* the Third Circuit Court of Appeals established the "hallmarks" of a permissible non-consensual creditor release of third parties.[42] The *Continental* court declined to establish a blanket rule for such releases, but the court rejected the release at issue because (1) the success of reorganization bore no relation to the releases and (2) the parties to be released did not provide consideration in exchange for the

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38 *See In re Continental Airlines*, 203 F.3d 203, 214 (3d Cir. 2000) ("The hallmarks of permissible non-consensual releases [are] fairness, necessity to the reorganization, and specific factual findings to support these conclusions….").

39 *Id.* at 212.

40 *See In re Spansion, Inc.*, 426 B.R. at 145 (explaining contribution from party to be released).

41 *Id.*

42 *See In re Continental Airlines*, 203 F.3d at 214 (explaining "hallmarks" of a proper release).

pending release.[43] Similarly, in *In the Matter of Genesis Health Ventures, Inc.*, the Delaware Bankruptcy Court ruled that the release had to be limited or stricken, and in so ruling, expanded upon the *Continental* "hallmarks": a non-consensual creditor release of third parties will be permissible when "(i) the non-consensual release is necessary to the success of the reorganization; (ii) the releasees have provided a critical financial contribution to the Debtor's plan; (iii) the releasees' financial contribution is necessary to make the plan feasible; and (iv) the release is fair to the non-consenting creditors, i.e., whether the non-consenting creditors received reasonable compensation in exchange for the release."[44] Similar to the Third Circuit's decision in *Continental*, the Delaware Bankruptcy Court in *Genesis* found the success of reorganization did not hinge on the releases, and while the non-consenting creditors may have received adequate consideration, the Third Circuit instructs that such releases shall only be upheld in "extraordinary cases."[45]

Despite this high threshold, the Delaware Bankruptcy Court occasionally upholds non-consensual creditor third-party releases. In deciding such a release is permissible, the court often applies the Third Circuit's analysis in *Continental* and a quasi-*Zenith* analysis, similar to the test that the court uses to determine the permissibility of a debtor's release of a third-party.[46] In *In re W.R. Grace & Co.*, the court dispensed with objections that the plan did not satisfy the contours of *Continental*. In an analysis similar to the non-consensual debtor releases applying *Zenith*, the

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43 *See id.* ("[W]e need not establish our own rule regarding the conditions under which non-debtor releases and permanent injunctions are appropriate or permissible.").

44 *In re Exide Technologies*, 303 B.R. at 58 (explaining *Genesis* factors).

45 *See In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 608 (Bankr. D. Del. 2001) (noting absence of the requisite "exceptional circumstances").

46 *See In re W.R. Grace & Co.*, 446 B.R. 96, 138 (Bankr. D. Del. 2011) (applying "fair and necessary" analysis).

In re W.R. Grace & Co. court reasoned, "We…find that the settlements are fair and necessary to the reorganization. The net value of the Sealed Air and Fresenius contributions are substantial—over $1 billion. The terms of the Sealed Air and Fresenius settlements provide that without the protections afforded Sealed Air and Fresenius under the Joint Plan their contributions would not be made. By contract, these entities have indemnity rights against Debtors that, if exercised, would deplete assets available to pay creditors" (cites and quotes omitted).[47] Without ever mentioning the *Zenith* test the court uses to judge debtor releases, the *In re W.R. Grace & Co.* court employed similar considerations en route to upholding the creditor release.[48]

V. CONCLUSION

The Delaware Bankruptcy Court's analysis of third-party releases depends in part on whether the release is consensual or non-consensual, as well as whether a debtor or a creditor is the releasing party. Regardless of who the releasing party is, consensual releases are generally permissible, but issues arise as to the definition of consensual in this context. Concerning non-consensual third-party releases by a debtor, the Delaware Bankruptcy Court applies the five-factor *Zenith* test to judge the permissibly of such releases. Alternatively, the Delaware Bankruptcy Court applies precedent from the Third Circuit's *Continental*, which the Delaware Bankruptcy Court expounded upon in *Genesis*, as a guide for non-consensual creditor releases of third parties. In either instance, the inquiry is highly fact-specific and the outcome will depend on the court's weighing of the equities surrounding the particular release at issue.

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47 *Id.*

48 *See id.* (finding requisite fairness and necessity).