# Hot Topics in Chapter 11

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# THIRD PARTY RELEASES IN CHAPTER 11: GET OUT OF JAIL FREE OR DO NOT PASS GO

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# THIRD PARTY RELEASES IN CHAPTER 11:
# GET OUT OF JAIL FREE OR DO NOT PASS GO

## I. INTRODUCTION

The status of the law regarding third-party releases in Chapter 11 bankruptcies can be described by the two most important instructions in the game of Monopoly: the majority view is akin to the fortunate "Get Out of Jail Free" card, and the minority view is represented by the dreaded "Do Not Pass Go." Nevertheless, recent lower court decisions are re-defining the game – it is not as black and white as it used to be. This paper presents a discussion of the varying positions from each of the Circuit Courts and offers practical considerations for dealing with a release issue.

## II. THE BASIS FOR THIRD-PARTY RELEASES—WHO ARE THE PLAYERS?

### A. The Typical Provisions and Protections.

A typical Chapter 11 plan of reorganization will seek to prevent creditors or other parties from pursuing various non-debtors involved in or related to the bankruptcy. These proposed "released parties" often include guarantors, insurers, the debtor's insiders, the debtor's management and professionals, and the official unsecured creditors committee and its professionals. The simplest and obvious reason for a release of these parties is to shield them from claims related to the bankruptcy itself, such as the formulation, solicitation, and implementation of the plan, and from claims that really are properly addressed in the plan. In general, the releases are usually embodied in the plan in sections referring to releases, exculpations, and discharge injunctions (referred to in this paper collectively as "non-debtor or third-party releases").

The arguments in favor of non-debtor releases may include the following: (1) they provide a motivation for compromise; (2) a non-debtor may contribute more to a trust fund or reorganization effort in exchange for a release and the assurance that it will not be sued later than it otherwise would without such a release; (3) releases can prevent unwarranted future litigation following the bankruptcy; (4) professionals who have labored through the bankruptcy process should not be subject to liability for merely performing their services; and (5) releases signal closure and finality to the entire bankruptcy process.[1]

The arguments against non-debtor releases may include the following: (1) creditors should not be required to relinquish claims, when contractually speaking, they may pursue a non-debtor irrespective of the bankruptcy filing; (2) a non-debtor should not be able to avail itself of the protections of the Bankruptcy Code (the "Code") when it did not file and subject itself to bankruptcy requirements; (3) professionals should not be able to escape liability for ethical violations; and (4) future litigation against a non-debtor—which would be impermissible under the release—may be a legitimate source of recovery for a creditor that receives little from the bankruptcy.[2]

Bankruptcy courts, as courts of equity, often weigh these arguments in the context of what is fair and equitable. As illustrated below, the bright-line results of many early decisions are beginning to erode.

**B. Majority vs. Minority View.**

The debate about the propriety of third-party releases has caused a split among the United States Circuit Courts. Comprising the majority view, the Second,[3] Third,[4] Fourth,[5] Sixth,[6]

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[1] *See* In re Yellowstone Mountain Club, LLC, 460 B.R. 254, 274-75 (D. Mont. 2011); *see generally* Elizabeth Gamble, *Nondebtor Releases in Chapter 11 Reorganizations: A Limited Power*, 38 FORDHAM URB. L.J. 821 (2010).
[2] *See generally* Gamble, *supra* note 1.
[3] In re Metromedia Fiber Network, Inc. (Metromedia), 416 F.3d 136, 141 (2d Cir. 2005).

Seventh,[7] Eighth,[8] and Eleventh[9] Circuits all allow for non-debtor third-party releases under certain circumstances. In contrast, the Fifth,[10] Ninth,[11] and Tenth,[12] Circuits fall under the minority view in holding that the Code prohibits non-debtor releases of any kind. As of yet, the First Circuit and DC Circuit's stances on third-party releases remain untested.

The majority relies primarily on the broad equitable powers granted to the bankruptcy courts through Section 105 of the Code. The minority, on the other hand, seeing a conflict between the broad authority of Section 105 and the specific allowances of Section 524(e), believes the Code prevents courts from allowing third-party releases, regardless of how limited they might be in scope or time.[13]

Even among the majority circuits, however, there is no common standard for when it is appropriate to confirm a third-party release. Indeed, "the only clear agreement is that whether such relief is appropriate must be determined on a case-by-case basis following a fact intensive inquiry."[14]

### C. The Relevant Statutes.

The critical statutes uniformly discussed by courts in their analysis of a third-party release issue are summarized below:

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[4] In re Lower Bucks Hosp., 571 F. App'x 139, 144 (3d Cir. 2014).
[5] Behrmann v. Nat'l Heritage Found., 663 F.3d 704 (4th Cir. 2011).
[6] In re Dow Corning Corp., 280 F.3d 648 (6th Cir. 2002).
[7] In re Ingersoll, Inc. 562 F.3d 856 (7th Cir. 2009); In re Airadigm Comm., Inc., 519 F.3d 640 (7th Cir. 2008).
[8] In re Master Mortg. Inv. Fund, Inc. (Master Mortg.), 168 B.R. 930 (8th Cir. 1994).
[9] In re Seaside Eng'g & Surveying, Inc. (Seaside), 780 F.3d 1070 (11th Cir. 2015).
[10] In re Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009).
[11] In re Lowenschuss, 67 F.3d 1394 (9th Cir. 1995).
[12] Abel v. West, 932 F.2d 898 (10th 1991); In re W. Real Estate, 922 F.2d 592 (10th Cir. 1990).
[13] *See infra* Section III; 11 U.S.C. § 524(e).
[14] Bruce R. Zirinsky, Rebecca D. Rosenthal and Paul T. Martin, *Competing Views on Plan Releases*, BLOOMBERG BNA, *available at* http://www.bna.com/competing-views-on-plan-releases/.

1. Section 105(a) of the Code gives a court the authority to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[15] It further provides that nothing prevents a court from, "sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process."[16] This section cuts both ways as support for or against a third-party release.

2. Section 524(e) of the Code provides that with narrow exceptions, "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."[17] While Section 524(e) does not explicitly reject third-party releases, it appears to leave open any claim arising from the bankruptcy against anyone besides the debtor.[18]

3. Section 1123(b)(6) of the Code provides that a plan may "include any other appropriate provision not inconsistent with the applicable provisions of this title."[19]

4. Section 1103(c) of the Code, which concerns the powers and duties of creditor committees, has been interpreted to provide quasi-immunity to committee members.[20]

## III. Do Not Pass Go But Maybe Get To Boardwalk—The Current Minority View.

As indicated previously, the Fifth, Ninth, and Tenth Circuits follow the minority view in holding that third-party releases are impermissible. For ease of discussion (and because of space limitations), the focus here is on Ninth Circuit case law as it serves as a good representation of how courts adhering to the minority view determine this issue.

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[15] 11 U.S.C. 105(a).
[16] *Id*.
[17] 11 U.S.C.A. § 524(e).
[18] *Id*.
[19] 11 U.S.C.A. § 1123(b)(6).
[20] 11 U.S.C.A. § 1103(c). *See also* In re L.F. Rothschild Holdings, Inc., 163 B.R. 45 (S.D.N.Y. 1994); In re Drexel Burnham Lambert Grp., Inc., 138 B.R. 717 (Bankr. S.D.N.Y. 1992).

In general, the Ninth Circuit interprets § 524(e) to mean that third-parties cannot be released from liability. It is not a matter of whether the creditors are willing to accept the release; the Ninth Circuit considers bankruptcy courts to be restrained in this matter by the Code itself. Nonetheless, the cases contain language that supports exceptions. Three major decisions comprise the Ninth Circuit's position on third-party releases: *Underhill v. Royal* (1985),[21] *In re American Hardwoods* (1989),[22] and *In re Lowenschuss* (1995).[23]

**A. The Ninth Circuit View.**

1. Underhill v. Royal

In *Underhill v. Royal*, the Ninth Circuit considered whether a personal release in the plan of reorganization barred an action for securities law violations perpetrated by the principal shareholder of two companies in Chapter 11.[24] The provision in question released the debtor and "any affiliate of the Debtor, and any insider of the Debtor."[25] Although the bankruptcy court conditionally confirmed the plan, the district court rejected the release as a matter of law under Section 524(e).[26]

On appeal, the Ninth Circuit reasoned that 11 U.S.C. § 524(e) was a "reenactment" of Section 16 of the 1898 Act which provided that "[t]he liability of a person who is a co-debtor with, or guarantor or in any manner a surety for, a bankrupt shall not be altered by the discharge of such bankrupt."[27] Thus, the Ninth Circuit concluded, "under the old Act, stockholders or directors could remain liable for substantive violations despite discharge of the corporate

[21] Underhill v. Royal, 769 F.2d 1426 (9th Cir. 1985).
[22] In re Am. Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989).
[23] *Lowenschuss*, 67 F.3d 1394.
[24] *Underhill*, 769 F.2d 1426.
[25] *Id*. at 1430.
[26] *Id*. at 1432.
[27] *Id*. at 1432 (citing Act of July 1, 1898, ch. 541, § 16, 30 Stat. 550 (formerly codified at 11 U.S.C. § 34 (1976))).

entity."[28] The Ninth Circuit explained that "when a bankruptcy court discharges the debtor, it does so by operation of the bankruptcy laws, not by consent of the creditors."[29] In essence, under Section 524(e), third-party releases are ineffective because the Code does not allow bankruptcy courts the power to discharge non-debtor liability.

2. In re American Hardwoods, Inc.

In *American Hardwoods*, the court was concerned with whether a bankruptcy court has the jurisdiction and power to permanently enjoin a creditor from enforcing a state court judgment against non-debtors through confirmation of a plan of reorganization.[30] The Ninth Circuit recognized that bankruptcy courts have *jurisdiction* over any matter that "could conceivably" have any effect on the plan.[31] However, it held that bankruptcy courts lack the *power* under Section 105(a) to permanently issue such an injunction.[32]

Nevertheless, *American Hardwoods* seems to contemplate an exception in the event of "unusual facts," such as those in *In re A.H. Robins Co.*[33] The Ninth Circuit distinguishes *A.H. Robins Co.* from the case before it by explaining that the reorganization in *American Hardwoods*: (1) does not contemplate the balancing of a large number of tort claimants alleging a large number of damages;[34] (2) the permanent injunction was not overwhelmingly approved by

[28] *Id*. (citing 1A J. Moore Collier on Bankruptcy ¶ 16.14, at 1551 (14th ed. 1978)).
[29] *Id*. *See also* Union Carbide Corp. v. Newboles, 686 F.2d 593, 595 (7th Cir.1982) (held ineffective a release of a guarantor despite the fact that it had been accepted by creditors and had already been confirmed by the bankruptcy court); R.I.D.C. Industrial Development Fund v. Snyder, 539 F.2d 487, 490 n. 3 (5th Cir. 1976) ("the bankruptcy court can affect only the relationships of debtors and creditors. It has no power to affect the obligations of guarantors").
[30] *Am. Hardwoods*, 885 F.2d at 623.
[31] *Id*. at 623-26.
[32] *Id*. ("American, however, points to no case, and we are aware of none, in which a court permanently enjoined, past confirmation of a plan, a creditor from enforcing a state court judgment against a nondebtor guarantor of a contract liability").
[33] In re A.H. Robins Co. (Menard-Sanford v. Mabey), 880 F.2d 694 (4th Cir. 1989).
[34] The reorganization in *A.H. Robins Co.* balanced 195,000 tort claimants alleging injuries totaling approximately $2.457 billion.

creditors;[35] (3) the injunctions would affect more than a tiny minority of its creditors;[36] and (4) the permanent injunction was not "essential to the plan," nor did "the entire reorganization [hinge] on it."[37] Because *American Hardwoods* contained none of these "unusual facts," the Ninth Circuit confirmed the district court's conclusion that it lacked power to permanently enjoin the creditors from state court actions against the non-debtor guarantors.[38] Thus, the case may provide a so-called "chink in the armor."

3. In re Lowenschuss

In the 1995 *Lowenschuss* opinion, the Ninth Circuit again considered whether the bankruptcy court erred in confirming a reorganization plan that released claims against non-debtors.[39] The reorganization plan at issue included a "Global Release"[40] provision that released numerous parties, including non-debtors, from all claims upon confirmation.[41] Reasoning that the

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[35] In *A.H. Robins Co.*, the reorganization plan, which included the injunction, was approved by over 94% of the claimants.
[36] In *A.H. Robins Co.*, the injunction only affected about 1.5% of the claimants.
[37] *Am. Hardwoods*, 885 F.2d at 626-27.
[38] *Id*. at 627.
[39] *Lowenschuss*, 67 F.3d at 1396.
[40] *Lowenschuss*' Reorganization Plan contained the following "Global Release":

> Global releases will be given to Debtor, Debtor's children ... Fred Lowenschuss Associates, a professional corporation, Fred Lowenschuss Associates Pension Plan, as well as releasing of all liens against all trusts, custodian accounts, pension plan, Fred Lowenschuss Associates and satisfying of all outstanding judgments, executions, and levies against the aforementioned or any person or entity connected with them.

Plan of Reorganization ¶ 5D. The confirmation order elaborated:

> Entry of this Order shall constitute a release of all liens, levies, freezes, attachments and garnishments against Debtor, individually or as trustee, held or claimed to be held by Beverly Selnick, Resorts International, Inc., or anyone else, or issued by this Court or by any other court, and collections sought by Beverly Selnick by reason of any judgment, or for any other reason, against the Debtor, the Fred Lowenschuss Associates Pension Plan, Fred Lowenschuss Associates, a professional corporation, the Debtor's children ..., as well as all trusts and custodian accounts managed by Debtor.

Confirmation Order ¶ 4.
[41] *Lowenschuss*, 67 F.3d at 1397.

bankruptcy court lacked the power to confirm plans which did not comply with the Code, the court affirmed the district court's ruling vacating the Global Release provision.[42]

*Lowenschuss* explains that while 11 U.S.C. § 524(e) releases the debtor from all personal liability for debts, it does not provide for the release of third-parties from liability.[43] "To the contrary," the court writes, "§ 524(e) specifically states 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.'"[44] *Lowenschuss* seemingly lays to rest the possibility of approving non-debtor releases, and makes clear that the Ninth Circuit "has repeatedly held, without exception, that § 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors."[45] Because the Global Release provision was contrary to Section 524(e), the Ninth Circuit affirmed vacating the release.[46] But, is this really the last word?

**B. Recent Developments in the Ninth Circuit Bankruptcy and District Courts.**

Since the above core Ninth Circuit cases, there have been several bankruptcy and district court decisions that appear to be reshaping the landscape of third-party releases. These include: *In re WCI Cable, Inc.*,[47] *In re Western Asbestos Co.*,[48] *In re Yellowstone Mountain Club, LLC*,[49] and *In re South Edge LLC*.[50]

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[42] *Id*. at 1402.
[43] *Id*. at 1401.
[44] 11 U.S.C. § 524(e); *Lowenschuss*, 67 F.3d at 1401.
[45] *Lowenschuss*, 67 F.3d at 1401.
[46] *Id*. at 1402.
[47] In re WCI Cable, Inc., 282 B.R. 457 (Bankr. D. Or. 2002).
[48] In re W. Asbestos Co., 313 B.R. 832 (Bankr. N.D. Cal. 2003).
[49] *Yellowstone*, 460 B.R. at 254.
[50] In re S. Edge LLC, 478 B.R. 403 (D. Nev. 2012).

1. In re WCI Cable, Inc.

In *WCI Cable*, the court approved two release provisions in a joint plan of reorganization that limited the scope of the releases to post-petition acts and omissions.[51] The plan included an exculpation clause for the creditors' committee members and their agents "for any of their actions or omissions to act with respect to the…bankruptcy proceedings, except for willful misconduct or *ultra vires* acts."[52] The court stated it was willing to approve the group exculpation clause, but only if the exculpation exceptions were extended to cover negligence and breaches of fiduciary duty, in addition to covering gross negligence and willful misconduct.[53] The court further held that the entire group exculpation clause was a severable provision from the plan.[54]

The court interpreted Section 1103(c) of the Code as providing a limited grant of immunity to creditor committee members. While it acknowledged that "it is inappropriate to use § 105(a) substantively to effect results that are inconsistent with other provisions of the Bankruptcy Code," the court found that here, there was no inconsistency to resolve.[55] The court approved the exculpation clause by treating it as a standard of care rather than as an exculpation clause.[56] Because the Code itself provides for limitation of immunity, the court saw no conflict with the limitation of liability provisions outlined in the plan and dismissed the Section 524(e) argument.[57] The *WCI Cable* court was wary of issuing a broad "Get Out of Jail Free" card, but,

[51] *WCI Cable*, 282 B.R. at 477.
[52] *Id*. at 476.
[53] *Id*. at 479-80.
[54] *Id*. at 480.
[55] *WCI Cable*, 282 B.R. at 468.
[56] *Id*. at 476-77. Persuaded by the Third Circuit's reasoning in *In re PWS Holding Corp.*, 228 F.3d 224, 245-47 (3d Cir. 2000), the Oregon district court declared that "the Creditors Committee Exculpation Clause does not provide a prohibited release of nondebtor liability, but in fact does no more than state clearly the appropriate standard of immunity of Creditors Committee members in performing their functions under § 524(e)."
[57] *Id*. at 477. The court explained:

with the proper limitations on the scope of the release in place, neither was the court going to call "game over."

2. In re Western Asbestos Co.

In *Western Asbestos*, insurers objected to the plan, arguing that it contained an improper release against the plan's proponents and their agents.[58] Relying on *WCI Cable*, they believed the provision was "overbroad in three respects: (1) by releasing claims against the Plan Proponents other than the Debtors, (2) by releasing claims against the Plan Proponents' agents, including their attorneys, and (3) by covering pre-petition actions or omissions."[59]

In response, the court significantly extended the ruling in *WCI Cable*, and held that "the release provisions may include all of the Plan Proponents and their agents, including their professionals, and may apply to pre-petition as well as post-petition acts."[60] Why did the bankruptcy court embark on such a departure from Ninth Circuit precedent and other decisions such as *WCI Cable*? The court distinguished the two cases succinctly:

> It may have made sense in the context of *WCI Cable* to limit the scope of the release to post-petition acts and omissions. However, it does not make sense to do so here. The Plan Proponents and their professionals were clearly engaged in negotiating the settlement upon which the Plan is based and in preparing for the bankruptcy filing in a variety of other ways long before the cases were filed. If

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> The limitation of liability provisions for Creditors Committee members and their agents, *other than professionals*, included in the Creditors Committee Exculpation Clause cover no more and no less than the limited immunity for creditors' committee members performing their functions under the Bankruptcy Code contemplated in § 1103(c). Accordingly, I find that the Creditors Committee Exculpation Clause complies with, and is not inconsistent with, applicable provisions of the Bankruptcy Code. (Emphasis added).

Interestingly, the court did seem to exclude Creditors Committee "professionals" from its understanding of who is granted limited immunity by Section 1103(c).

[58] *W. Asbestos Co.*, 313 B.R. at 846 ("Section 8.4 provides that neither the Plan Proponents nor any of their agents, including their attorneys, shall be liable, other than for willful misconduct, with respect to any action or omission prior to the effective date in connection with the Debtors' operations, the Plan, or the conduct of the bankruptcy case. This provision includes actions and omissions that took place before these bankruptcy cases were filed").

[59] *Id*. at 846.

[60] *Id*. at 847.

> they are entitled to a release for their post-petition acts or omissions, they are also entitled to a release for these pre-petition acts or omissions.[61]

*Western Asbestos* adds to the slowly evolving Ninth Circuit view on third-party releases by stating that it is permissible for releases to apply to pre-petition acts and omissions. However, the opinion cautions that is not acceptable for the provision to "release any claim based on the operation or management of the business regardless of whether that act or omission had anything to do with the bankruptcy case and without any limit as to time."[62] Unlimited, unfettered, and unspecific releases are beyond the court's powers, at least in the Ninth Circuit; but as long as the acts and omissions covered by the release are related to the bankruptcy, the release may extend both to pre-petition and post-petition actions.

3. <u>In re Yellowstone Mountain Club, LLC</u>

*Yellowstone* also bends the Ninth Circuit's stringent precedent by proposing that language limiting the scope and time of a release is the key to confirming a plan containing a third-party release. In *Yellowstone*, the court affirmed the approval of a plan's exculpatory clauses and releases in favor of third-parties.[63] In reaching its decision, the court distinguished the case at issue from Ninth Circuit precedent by the release's limited nature:

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[61] *Id.*
[62] *Id.*
[63] *Yellowstone*, 460 B.R. at 267. The approved provision, as it appears in the Debtor's Third Amended Joint Plan of Reorganization, reads:

> None of (a) the Debtors or the Reorganized Debtors, (b) the Committee, (c) the individual members of the Committee in their capacities as such, (d) the DIP Lender, any other lenders of (or participants in) the DIP Loan and any agent thereof, (e) the Current Equity Owners, (f) CrossHarbor Capital Partners and all affiliates thereof, (g) the Acquirer, (h) the First Lien Lenders and the First Lien Agent, and (i) with respect to each of the foregoing Persons, each of their respective directors, officers, employees, agents (including Edra Blixseth, as managing member of the Current Equity Owners), representatives, shareholders, partners, members, attorneys, investment bankers, restructuring consultants and financial advisors in their capacities as such (collectively, the "Exculpated Parties "), shall have or incur any liability to any Person for any act or omission in connection with**, relating to** or **arising out of the Chapter 11 cases**, the

> This court is bound by, and does not dispute the legal precedent established in *Lowenschuss, American Hardwoods*, and *Underhill,* that liabilities of non-debtors cannot be discharged through a plan. Such legal precedent, however, is inapplicable here because, unlike in *Lowenschuss, American Hardwoods*, and *Underhill*, ¶ 8.4 of the Debtors' Third Amended Joint Plan of Reorganization is not a broad sweeping provision that seeks to discharge or release non-debtors from any and all claims that belong to others.[64]

The court found that the release provision was limited in scope and time because it only encompassed actions arising in connection with the plan.[65] Looking at the language of the provision, this might come as a surprise.[66] *Yellowstone* makes a splash in Ninth Circuit doctrine because the court determined that the terms “relating to” and “arising out of the Chapter 11 cases” qualify as limiting language.[67] The court also paid particular attention to the fact that the exculpation clause was not a last minute provision added without notice to all parties, and to the fact that willful misconduct and gross negligence were excluded.[68]

The court seems to have based its ruling in part on its belief that a specific third-party earned being included in the exculpation clause because it “had the ability to single-handedly disrupt the entire confirmation process.”[69] When third-party releases are essential to the success of a plan of reorganization, they may be considered necessary concessions. Due to the fact that the exculpation clause was temporal in nature, that it only covered parties who were closely

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> formulation, negotiation, implementation, confirmation or consummation of this Plan, the Disclosure Statement, or any contract, instrument, release or other agreement or document entered into during the Chapter 11 Cases or otherwise created in connection with this Plan; provided, however, that nothing in this Section 8.4 shall be construed to release or exculpate any Exculpated Party from willful misconduct or gross negligence as determined by a Final Order or any breach of the Definitive Agreement or any documents entered into in connection therewith. (Emphasis added).

[64] *Id*. at 270.
[65] *Id*. at 271-73.
[66] *See supra*, note 63.
[67] *Yellowstone*, 460 B.R. at 271-72.
[68] *Id*. at 266.
[69] *Id*. at 275.

involved, and that the court viewed the exculpation clause as being crucial to the success of the Chapter 11 plan, the court approved the plan even though it contained a third-party release.[70]

4. In re South Edge LLC

In *South Edge*, the court held that the exculpation clause did not violate the Ninth Circuit's prohibition on nonconsensual third-party releases.[71] First acknowledging that Ninth Circuit precedent prohibits the nonconsensual release of third-parties as a matter of law, the court rephrased the issue:

> The question thus becomes whether the exculpation clause in section 8.10 of the Plan improperly releases third-parties liability or whether it merely sets the standard of care in this bankruptcy proceeding which would preempt the assertion of any state law claims which seek to impose a different standard of care.[72]

*South Edge* stands for the proposition that if an exculpation clause is simply stating the standard of care and reiterating federal preemption principles—not just purporting to release third-parties from liability to a nonconsenting non-debtor—then it is permissible.[73] As in *Yellowstone*, here too, the court believed it was beneficial to incorporate a third-party release into the plan.

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[70] *Id*. at 277.

[71] *S. Edge*, 478 B.R. at 416. Section 8.10, the exculpation clause provides:

> None of (a) the Debtor, the Reorganized Debtor, or the Estate Representative, (b) the Agent, (c) the Consenting Prepetition Lenders, (d) the Settling Builders, (e) the TIP Loan Lenders, (f) the Trustee, and (g) with respect to each of the foregoing Entities, their respective directors, officers, employees, agents, representatives, shareholders, partners, members, affiliates, attorneys, investment bankers, restructuring consultants, and financial advisors in their capacities as such (collectively, the "Exculpated Parties"), shall have or incur any liability to any Entity for any act or omission in connection with, relating to, or arising out of the Chapter 11 Case, the Disclosure Statement, or any contract, instrument, release, or other agreement or document entered into during the Chapter 11 Case or otherwise created in connection with this Plan; provided, however, that nothing in this Section 8.10 shall be construed to release or exculpate any Exculpated Party from (i) its obligations set forth in this Plan, or (ii) willful misconduct or gross negligence as determined by a Final Order.

[72] *Id*. at 415.

[73] *Id*. at 414-15.

In *South Edge*, the district court permitted the releases to remain in the plan, finding that the exculpation clause and releases (1) were integral elements to the plan, (2) conferred material benefit on the Plan Proponents, (3) were important to overall objectives of the plan, (4) were consistent with the Code, (5) were made in exchange for valuable consideration, and (6) were properly noticed to Holders of Claims and Equity Interests.[74] Further, every secured and unsecured creditor who returned a ballot supported the Plan.[75] Several of these considerations are remarkably similar to factors permissive-view circuits employ to determine whether to approve third-party releases.[76]

Both the *Dow Corning* and *Master Mortgage* tests, discussed in Part IV, take into consideration whether the third-parties seeking releases have "contributed substantial assets" to the reorganization effort.[77] While neither opinion explicitly defines what constitutes "substantial assets," *Master Mortgage*'s reasoning is insightful. That opinion provides that a third-party's assignment of participation interests and release of collateral interests in notes and mortgages qualifies as valuable consideration.[78] Those contributions were valued at four million dollars and allowed for distributions to other creditors.[79] Further, the *Master Mortgage* opinion distinguishes its facts from those of the Tenth Circuit's *Western Real Estate* and the Ninth Circuit's *American Hardwoods* by focusing on the lack of "substantial contributions" in either of the latter two cases.[80]

[74] *Id*. at 409.
[75] *Id*. at 407.
[76] *See infra* Section IV.
[77] *Dow Corning*, 280 F.3d at 658; *Master Mortg.*, 168 B.R. at 935.
[78] *Master Mortg.*, 168 B.R. at 938.
[79] *Id*. at 938.
[80] *Id*. at 937 (noting that the third party in *Western Real Estate* "did not provide new and substantial contributions to the reorganized debtor," and the non-debtor guarantors in *American Hardwoods* "did not offer to contribute assets to [the] bankruptcy estate").

*Seaside Engineering*, which follows the *Dow Corning* factors (discussed in Part IV.B.), clarifies that labor also qualifies as contributing substantial assets to the reorganization.[81] After all, "the contribution of [the third-party's] services to the reorganized entity [can be] the very 'life blood of the reorganized debtor.'"[82]

Perhaps surprisingly, even Ninth Circuit district court decisions take into account whether third-parties contribute substantial assets to the reorganization.[83] *South Edge* includes among its list of substantial contributions "the payment of millions of dollars," "the prepetition lenders' consent to the Plan despite a deficiency of approximately $47 million," and "the resumption of development on the project."[84] While *South Edge* particularly notices material benefits, it also recognizes 'team-player' actions such as consent despite having a significant interest in withholding that consent, and a willingness to push forward, as substantial contributions to the reorganization.[85] "Substantial consideration," therefore, can include labor and team-player concessions in addition to monetary contributions.

Although *Underhill*, *Western Asbestos*, and *Lowenschuss* make clear that the Ninth Circuit does not approve of nonconsensual third-party releases, newer bankruptcy and district court decisions such as *WCI Cable*, *Western Asbestos*, *Yellowstone*, and *South Edge* are slowly swinging the pendulum toward the majority circuit view, creating opportunities for releases and exculpations that until recently did not exist.

### C. The Fifth and Tenth Circuits.

The Fifth and Tenth Circuits also adhere to the minority view. In *Western Real Estate*, the Tenth Circuit explicitly espouses the restrictive view on third-party releases found in the

[81] *Seaside*, 780 F.3d at 1080.
[82] *Id.*
[83] *S. Edge*, 478 B.R. at 416; *Yellowstone*, 460 B.R. at 265.
[84] *S. Edge*, 478 B.R. at 416.
[85] *Id.* at 416. *See also Yellowstone*, 460 B.R. at 265 (noting with approval testimony that a third-party made "substantial [monetary] concessions critical to confirmation of the Plan" and agreed to subordinate another claim).

Ninth Circuit's *American Hardwoods*.[86] In that case, the court analyzes the language of Section 524 and its gaps, reasoning that Congress must not have intended to extend the benefits afforded to debtors under Section 524 to third-party bystanders.[87] According to the Tenth Circuit, one of the main problems with the injunction in *Western Real Estate* is its explicitly permanent nature, extending post-confirmation.[88] One year later, in *Abel v. West*, the Tenth Circuit allowed a temporary third-party injunction during the development and evaluation of the reorganization plan, but confirmed its holding in *Western Real Estate*, firmly stating once again that a permanent injunction, post-confirmation, would be inappropriate.[89]

In *Pacific Lumber*, the Fifth Circuit noted that the Code explicitly permits bankruptcy courts to enjoin third-party asbestos claims under Section 524(g).[90] To the Fifth Circuit, this specificity "suggests non-debtor releases are most appropriate as a method to channel mass claims toward a specific pool of assets," but not appropriate otherwise.[91] *Pacific Lumber* disfavored the exculpation clause at issue because it purported to release parties from any negligent conduct that occurred during the bankruptcy.[92] Yet, the Fifth Circuit ruled it would uphold the provisions releasing the creditors' committee and its members—based on the qualified immunity afforded them in Section 1103(c)—so long as the released actions were within the scope of their duties and the release did not shield them from willful misconduct or gross negligence.[93] This position evidences a significant erosion of the rigid doctrine previously adopted.

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[86] *W. Real Estate*, 922 F.2d at 601-02.
[87] *Id*. at 600.
[88] *Id*.
[89] *Abel*, 932 F.2d at 899.
[90] *Pac. Lumber*, 584 F.3d at 252.
[91] *Id*. at 252.
[92] *Id*.
[93] *Id*. at 253.

## IV. The Other Side of the Game: Other Circuits Have Less Stringent Third-Party Release Standards.

### A. In the Majority Circuits, Releases Limited by Scope and Time are Most Likely to Succeed: Lessons from the Second and Seventh Circuits.

The majority view allows consensual and nonconsensual third-party releases because of the important role releases can play in developing a plan of reorganization. There are limitations, however. The balance is in ensuring that the releases reflect and reward the effort put into restructuring the debtor, but at the same time, do not unnecessarily obstruct a claimant's path to recompense.

The Second and Seventh Circuits are good examples of this principle. In the Second Circuit, bankruptcy courts may enjoin creditors from suing third-parties, "provided the injunction plays an important part in the debtor's reorganization."[94] The case of *In re Metromedia Fiber Network, Inc.*, a seminal Second Circuit decision, acknowledges the rationale for the minority circuits' reluctance to approve non-debtor releases, but nonetheless, approves of third-party releases in "unique" circumstances.[95]

In its reasoning, the *Metromedia* court recognizes several justifications for a court's disapproval of non-debtor releases.[96] The first comes from a lack of explicit authorization in the Code, and the second from the fact that non-debtor releases lend themselves to abuse.[97] Through a release, "a non-debtor can shield itself from liability to third-parties. In form, it is a release; in effect it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code. The potential for abuse is heightened when releases afford blanket immunity."[98] The Second Circuit outlines exactly how *not* to draft a non-debtor release:

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[94] *Metromedia*, 416 F.3d at 141.
[95] *Id*.
[96] *Id*.
[97] *Id*. at 142.
[98] *Id*.

> Here, the [impermissible] releases protect against any claims relating to the debtor, "whether for tort, fraud, contract, violations of federal or state securities laws, or otherwise, whether known or unknown, foreseen or unforeseen, liquidated or unliquidated, fixed or contingent, matured or unmatured."[99]

Echoing the Second Circuit's *Metromedia* decision, the Seventh Circuit's *Airadigm* opinion proposes that a non-debtor release will not be approved if it amounts to 'blanket immunity' without limitations as to time or scope.[100] Thus, the important consideration is whether the third-party's "essential" participation in the plan process depended on its being granted a release.[101] Looking at the specific facts of each case, the court must determine whether the release was "necessary for the reorganization" and "appropriately tailored."[102] The release must be narrow enough so that the limitation applies only to claims "arising out of or in connection with the reorganization," and also must exclude "willful misconduct."[103] The Second Circuit cautions that approval of a release "is not a matter of factors and prongs,"[104] and a release will not be approved "absent the finding that truly unusual circumstances render the release terms important to success of the plan."[105]

A recent case from the Southern District of New York, *In re Chassix Holdings, Inc.*, addresses in detail the propriety of opt-in versus opt-out voting procedures to approve third-party releases, and defines who may fairly be called a "consenting creditor."[106] In *Chassix*, the debtors proposed to include a provision in the voting ballot that would allow creditors to indicate

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[99] *Id*.
[100] *Ingersoll*, 562 F.3d at 864 (quoting *Airadigm*, 519 F.3d at 657).
[101] *Id*.
[102] *Airadigm*, 519 F.3d at 657.
[103] *Id*.
[104] *Metromedia*, 416 F.3d at 142.
[105] *Id*. at 143.
[106] In re Chassix Holdings, Inc. (Chassix), No. 15-10578 (MEW), 2015 WL 4122976 (Bankr. S.D.N.Y. July 9, 2015).

whether or not they consented to the releases contained in the plan.[107] Rather than using the debtors' proposed "opt-out" method, the creditors committee instead asked that there be an affirmative "opt-in" form of ballot concerning the releases, separate and distinct from a vote for approving or rejecting the plan.[108] Although the court reasoned that other courts have approved voting procedures similar to the active "opt-out" system offered by the debtor, it noted that "there is little to no guidance in the reported cases as to the factors that a Court properly should consider in deciding *whether* to approve such procedures in the first place."[109] Here, the court was not persuaded that the proposed opt-out procedures were appropriate.[110]

Instead, the court took a self-directed approach, with the following results: (1) Under both the proposed and approved procedure, if the creditor voted in favor of the plan, it was deemed to consent to the releases; (2) Under both the proposed and approved procedure, if a creditor rejected the plan, but separately elected to opt-in to the release, it was deemed to consent; (3) The debtors' plan provided that if the creditor rejected the plan, but took no action on the release, it was deemed to consent to the release. The court, on the other hand, reasoned that if the creditor rejected the plan and took no further action, it was deemed to reject the releases; (4) The debtors interpreted inaction as consenting, whereas the court considered inaction as nonconsenting; and finally, (5) The debtors interpreted unimpaired creditors as consenting, but the court considered unimpaired creditors to be nonconsenting.[111]

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[107] *Chassix*, 2015 WL 4122976, at *10.
[108] *Id*. at *10.
[109] *Id*.
[110] *Id*. at *11.
[111] *Id*. at *12-14. Compare the confirmed definition of "consenting creditor" ("***Consenting Creditors*** means (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") with the proposed definition ("Consenting Creditors means (a) any holder of a Claim other than any holder who voted to reject the Plan and elected not to provide the release (as set forth on the applicable ballot), and (b) any Released Party").

In addition to modifying the definition of "consenting creditor," as described above, the court also limited the scope of the releases, insisting that they "relate only to matters that directly involve the Debtors and the parties' dealings with the Debtors."[112] The court elaborated that appropriate voting procedures may vary case to case: "Just as the *Metromedia* decision recognized that different cases might support different outcomes with respect to the imposition of involuntary third party releases, so too those same considerations could support different outcomes as to the voting procedures in individual cases."[113]

In contrast, in *In re Ecotality*, an unpublished but instructive decision, the Arizona bankruptcy court declined to approve releases despite the ability for a creditor to opt out of granting the proposed releases.[114] The court adhered strictly to the Ninth Circuit decision in *Lowenschuss*. However, the court did find, similar to the *Chassix* court, that the release provision could be severed from the plan and confirmation could be approved. *See* Appendix A.

**B. The *Dow Corning* Factors: The Fourth, Sixth, and Eleventh Circuits.**

The Sixth Circuit's *In re Dow Corning* case sets forth a widely-used seven-factor test to determine when it is appropriate for a bankruptcy court to enjoin non-consenting creditors' claims against non-debtors.[115] The Fourth[116] and Eleventh[117] Circuits also adhere to the *Dow Corning* factors and allow both consensual and nonconsensual injunctions. The presence of all seven factors signals that the case contains "unusual circumstances," thereby making it

[112] *Id*. at *14.
[113] *Id*. at *11.
[114] *In re Ecotality*, No. 2:13-BK-16126 (MCW) (Bankr. D. Ariz. Apr. 10, 2015).
[115] *Dow Corning*, 280 F.3d at 655-56, 658.
[116] *Behrmann*, 663 F.3d at 712 (approving of *Dow Corning* and *In re Railworks Corp.* factors while still cautioning that non-debtor releases should be granted "cautiously and infrequently").
[117] *Seaside*, 780 F.3d at 1079.

permissible for a bankruptcy court to approve a non-consensual non-debtor release.[118] The seven factors are:

> (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."[119]

For the circuits following *Dow Corning*, the seventh factor—that the bankruptcy court must make specific factual findings—may make the difference between confirmation and a situation where the provisions are remanded or stricken from the plan altogether.[120]

The case of *Seaside Engineering* makes the Eleventh Circuit the most recent addition to the majority view circuits.[121] In *Seaside Engineering*, the Eleventh Circuit, like the Fourth Circuit in *Behrmann*, follows the *Dow Corning* test.[122] Expounding that bankruptcy courts should have discretion in deciding which of the seven factors will be relevant in each case, *Seaside Engineering* also reminds its bankruptcy courts that the factors comprise a nonexclusive

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[118] *Dow Corning*, 280 F.3d at 658.
[119] *Id*.
[120] In *Dow Corning* itself, the Sixth Circuit remanded the injunction provision because the bankruptcy court failed to make the factual findings necessary to support its finding of unusual circumstances. *See Dow Corning*, 280 F.3d at 653. In *Behrmann*, the Fourth Circuit vacated the provisions on the grounds that the bankruptcy court failed to make "specific factual findings" explaining why the release provisions were "essential," "important," materially beneficial, "integral," and consistent with applicable provisions. *See Behrmann*, 663 F.3d at 712-13.
[121] *Seaside*, 780 F.3d at 1076-77.
[122] *Id*. at 1079.

list.[123] As with all circuits that allow non-debtor third-party releases, the Eleventh Circuit cautioned that such releases should be approved "cautiously and infrequently," and "only where essential, fair, and equitable."[124] It elaborates that the determination of whether third-party releases are necessary to the success of the reorganization is "fact intensive in the extreme."[125] *Seaside Engineering* is a particularly helpful case because it walks through each of the *Dow Corning* factors, applying them methodically.

### C. The *Master Mortgage* Factors: The Third and Eighth Circuits.

The Third[126] and Eighth[127] Circuits follow the majority view, interpreting Section 105 as granting broad equitable authority to the bankruptcy courts, including the ability to approve releases when necessary and proper to the reorganization. These circuits hold that exercise of the power to grant permanent releases is discretionary only.[128]

The Eighth Circuit's *Master Mortgage* test involves five important but unexclusive factors in its fact-specific review:

> Whether (1) an identity of interest exists between the debtor and the third-party, (2) the nondebtor has contributed substantial assets to the reorganization, (3) the injunction is essential to the success of the reorganization, (4) a substantial majority of the creditors agree to such injunction, specifically, the impacted class(es) have "overwhelmingly" voted to accept the proposed plan treatment, and (5) the plan provides a mechanism for the payment of all or substantially all, of the claims of the class(es) affected by the injunction.[129]

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[123] *Id*.
[124] *Id*. (quoting *In re Munford*, 97 F.3d 449, 455 (11th Cir. 1996)).
[125] *Id*.
[126] *Lower Bucks Hosp.*, 571 F. App'x at 144.
[127] *Master Mortg.*, 168 B.R. at 934.
[128] *Master Mortg.*, 168 B.R. at 937.
[129] *Id*. at 935. The Third Circuit, in *Indianapolis Downs*, states that it adheres to the five-part test in *In re Zenith Electronics Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999). As this test is identical to the *Master Mortgage* test, we will use that descriptive phrase solely.

This test restates exactly the first five factors of the seven-part *Dow Corning* test, omitting only the considerations that the plan must provide an opportunity for the claimants who choose not to settle to recover in full, and that the bankruptcy court must make specific factual findings supporting its conclusions.[130] The court "cautions the Gentle Reader that a permanent injunction is a rare thing, indeed, and only upon a showing of exceptional circumstances in which the factors outlined above are present will this Court even entertain the possibility of a permanent injunction."[131]

Unlike the Eighth Circuit, which allows for both consensual and nonconsensual releases, the Third Circuit only allows releases when they are consensual.[132] One Third Circuit district court decision, *Indianapolis Downs*, addressed whether the third-party releases at issue were consensual.[133] The plan in that case provided that anyone who failed to opt out or vote on the plan was still "deemed" to consent to the third-party release.[134] After analyzing the facts of the case through the five-factor *Master Mortgage* test, and finding that the majority of the factors had been met, the court characterized the releases as consensual, and confirmed the plan.[135]

## V. THE QUEST FOR THE ILLUSTRIOUS GET OUT OF JAIL CARD

Although the courts emphasize the rarity of confirming plans releasing third-parties, in practice, bankruptcy courts frequently approve non-debtor third-party releases, even in minority view courts. The requirements obviously vary in each jurisdiction; however, as indicated above, there appears to be a healthy amount of cross-pollination between the liberal majority rule and the strict minority rule. Clearly, in all cases conspicuous disclosure, a clear identification of the

[130] *Dow Corning*, 280 F.3d at 658.
[131] *Master Mortg.*, 168 B.R. at 937.
[132] In re Indianapolis Downs, LLC, 486 B.R. 286 (Bankr. D. Del. 2013).
[133] *Id.*
[134] *Id.* at 304-05. Compare with ruling in *Chassix*, discussed in Part IV.A, and *see* example from *Ecotality* case in Appendix A.
[135] *Indianapolis Downs*, 486 B.R. at 306.

released parties, limitation in scope, an explanation of the importance of the releases, and an exclusion of gross and willful misconduct are critical elements to a successful third-party release provision.[136] It goes without saying that a willingness to negotiate a release provision is the pathway to GO and collecting the cherished $200.

[136] See e.g. Bank of N.Y., Mellon Trust Co., NA v. Becker (Becker.), No. 12-3399, 12-3752 (E.D. Pa. Jan. 2, 2013); *Lower Bucks Hosp.*, 571 F. App'x at 144. Although the Third Circuit allows for consensual third-party releases, the court refused to approve them here due to their inconspicuous nature. The Third Circuit admonished the authors of the release for neglecting to follow Section 1125 of the Code and Fed. R. Bankr. P. 3016(c): "Key terms of a plan of confirmation, particularly those that release a non-debtor from claims by creditors, must be adequately disclosed. Failure to do so in a clear and conspicuous manner risks excision of the release from the plan. That is what occurred here, and thus we affirm."

## Table of Authorities

Cases

1. Abel v. West, 932 F.2d 898 (10th 1991).
2. Behrmann v. Nat'l Heritage Found., 663 F.3d 704 (4th Cir. 2011).
3. In re A.H. Robins Co., 880 F.2d 694 (4th Cir. 1989).
4. In re Airadigm Commc'ns, Inc., 519 F.3d 640 (7th Cir. 2008).
5. In re Am. Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989).
6. In re Chassix Holdings, Inc., No. 15-10578 (MEW), 2015 WL 4122976 (Bankr. S.D.N.Y. July 9, 2015).
7. In re Dow Corning Corp., 280 F.3d 648 (6th Cir. 2002).
8. In re Drexel Burnham Lambert Grp., Inc., 138 B.R. 717 (Bankr. S.D.N.Y. 1992).
9. In re Ecotality, No. 2:13-BK-16126 (MCW) (Bankr. D. Ariz. Apr. 10, 2015).
10. In re Indianapolis Downs, LLC, 486 B.R. 286 (Bankr. D. Del. 2013).
11. In re Ingersoll, Inc., 562 F.3d 856 (7th Cir. 2009).
12. In re L.F. Rothschild Holdings, Inc., 163 B.R. 45 (Bankr. S.D.N.Y. 1994).
13. In re Lowenschuss, 67 F.3d 1394 (9th Cir. 1995).
14. In re Lower Bucks Hosp., 571 F. App'x 139 (3d Cir. 2014).
15. In re Master Mortg. Inv. Fund, Inc., 168 B.R. 930 (8th Cir. 1994).
16. In re Metromedia Fiber Network, Inc., 416 F.3d 136 (2d Cir. 2005).
17. In re Pacific Lumber Co., 584 F.3d 229 (5th Cir. 2009).
18. In re PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000).
19. In re Seaside Eng'g & Surveying, Inc., 780 F.3d 1070 (11th Cir. 2015).
20. In re S. Edge LLC, 478 B.R. 403 (D. Nev. 2012).
21. In re WCI Cable, Inc., 282 B.R. 457 (Bankr. D. Or. 2002).
22. In re W. Asbestos Co., 313 B.R. 832 (Bankr. N.D. Cal. 2003).
23. In re W. Real Estate, 922 F.2d 592 (10th Cir. 1990).
24. In re Yellowstone Mountain Club, LLC, 460 B.R. 254 (Bankr. D. Mont. 2011).
25. Underhill v. Royal, 769 F.2d 1426 (9th Cir. 1985).

Statutes and Rules

1. 11 U.S.C. § 105.
2. 11 U.S.C. § 524.
3. 11 U.S.C. § 1103.
4. 11 U.S.C. § 1123(b)(6).
5. Fed. R. Bankr. P. 3016(c).

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## Appendix A: Examples of Confirmed Third-Party Releases

### Example #1: *PRI* Plan

14. Section 7.3 of the Plan shall be replaced by the following language:

**Exculpation and Release**

Neither the Debtor nor any member of any Committee, nor any of either the Debtor's or Committees' officers, directors, employees, advisors, attorneys or agents (collectively, the "Released Parties") shall have or incur any liability for any act or omission in connection with, relating to or arising out of this Chapter 11 case, any settlement related to this Chapter 11 case which was approved by the Court or is authorized by the Plan, the solicitation of acceptances of the Plan, the negotiation and execution of a proposed Plan, the pursuit of confirmation of the Plan, the consummation of the Plan, the contracts, instruments, documents or releases created in connection with this Plan, the issuance and distribution of any securities expressly to be issued pursuant to the Plan, or the property to be distributed under the Plan, except only to the extent that liability is based on gross negligence, willful fraud, or ultra vires acts.

However, nothing in this provision is intended to affect, in any way, the obligations preserved or established by the Plan, and all documents related thereto. Furthermore, nothing in this provision shall apply to the sole Director or Oversight Committee, as created by the Plan, from the time that such positions become effective. Normal and reasonable standards of conduct shall apply with respect to such positions. Nothing in this paragraph is intended to absolve any professional of any liability that may be imposed by applicable rules of professional conduct governing such professional. Nothing in this limitation of liability will prevent or hinder parties authorized by the Plan from asserting claims or causes of action, including objections to Claims against the principals of the Debtor, the Pete & Mac's Entities other than the Claims resolved above in paragraphs 10 and 11, or any of their officers, directors, attorneys, shareholders, agents, partners, members, employees, representatives or affiliates, for acts or omissions which occurred or causes of action which arose prior to the Confirmation Date.

No other releases of third parties are intended.

### Example #2: *Surgical* Plan

7.3 **Exculpation and Release**

Pursuant to the Plan, the Debtor, the Committee, SCA, the Reorganized Debtor, and the PCO and all of their respective present and former partners, members, officers, directors, employees, advisors, attorneys and agents (collectively, the "Released Parties") shall not have or incur any liability to any holder of a Claim or an Interest, or any other party in interest, or any of their respective agents, employees, representatives, financial advisors, attorneys or Affiliates, or any of their successors or assigns for any act or omission in connection with, relating to or arising out of this Chapter 11 Case, any settlement related to this Chapter 11 Case, the negotiation and execution of a proposed Plan, the solicitation of acceptances of the Plan, the pursuit of confirmation of the Plan, the consummation of the Plan, or the administration of the Estate or of the Plan, issuance and distribution of any securities issued or to be issued pursuant to the Plan, or the Property to be distributed under the Plan, except only to the extent that liability is based on willful misconduct. The Released Parties shall be entitled to reasonably rely on the advice of counsel with respect to their duties and responsibilities under the Plan, or in the context of the Chapter 11 Case.

No other releases of third parties are intended by this Plan.

**<u>Appendix A: Examples of Confirmed Third-Party Releases</u>**

**Example #3: The Evolution of the *ECOtality* Releases**

| | |
|---|---|
| Minute Entry 12/31/2014 | Debtors' Joint Chapter 11 Plan of Reorganization contains broad releases of i) claims held by a non-debtor third party against another non-debtor third party (third party releases) and ii) claims held by the debtors or non-debtor third parties against professionals and other fiduciaries of the bankruptcy estate, such as directors and officers of the debtors (exculpations). Debtors' Ballot, at item number 3, contained an "opt out" permitting creditors to elect not to be bound by any grant of third party releases. Approximately 26 creditors opted out of the third-party release provisions. The United States Trustee objected to confirmation, arguing that the release and exculpation provisions are contrary to the Bankruptcy Code and Ninth Circuit authority. *See Resorts Intl., Inc. v. Lowenschuss* (*In re Lowenschuss*), 67 F.3d 1394 (9th Cir. 1995), cert. denied, 517 U.S. 1243, 116 S. Ct. 2497, 135 L. Ed. 2d 189 (1996). Bankruptcy Code Section 105(a) grants a court broad equitable power to issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. 11 U.S.C. §105; 28 U.S.C. §1334(b). Section 105(a) can only be exercised within the confines of the Bankruptcy Code. It does not authorize the bankruptcy courts to create substantive rights that are otherwise unavailable under applicable law, or constitute a roving commission to do equity. *In re Saxman*, 325 F.3d 1168, 1175 (9th Cir. 2003) (quoting *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986)). Section 524 restricts the broad equitable authority that §105(a) confers on the court; §524(e) specifically states, 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. Thus, §524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors and this court cannot confirm the Joint Plan with the third party releases. Further, in addition to being contrary to established Circuit authority, the court further finds that in this case, such releases are not fair and not necessary for reorganization. With respect to the exculpations, they are similarly overbroad as, among other things, they exceed the scope of the statutory quasi-immunity afforded members of the official committee under § 1103(c). For these reasons, the court declines to exercise any authority it may have to confirm a chapter 11 plan that includes the broad releases and exculpations. The court finds that the proposed releases, injunction and exculpation clauses are provisions severable from the Joint Plan. The court therefore severs these issues from the other confirmation issues so that the court may confirm the Joint Plan. As more fully set forth in the Findings of Fact, Conclusions of Law and Order (A) Approving the Debtors Disclosure Statement on a final basis and (B) Confirming the Debtors Joint Chapter 11 Plan of Reorganization, each of the other criteria under the Bankruptcy Code for confirmation of the Joint Plan has been satisfied and the court will therefore enter an order confirming the Joint Plan, reserving authority to modify the confirmation order with respect to the proposed releases, injunction and exculpation. (Entered: 12/31/2014) |

**Appendix A: Examples of Confirmed Third-Party Releases**

| | |
|---|---|
| Order Confirming Plan Amendment<br><br>Entered on 04/10/15 | The Plan "is amended as follows":<br><br>6. Notwithstanding anything to the contrary herein, the Plan or the Confirmation Order, the releases set forth in Section 9.3 of the Plan, with respect to the Plan Contributor, Blink Acquisition, LLC or Car Charging Group, Inc., and any of each of their current and former officers and directors, shareholders, affiliates, subsidiaries, principals, employees, agents, managers, trustees, partners, members, professionals, representatives, advisors, attorneys, financial advisors, accountants, investment bankers and consultants, shall become effective only upon the full and final satisfaction of any and all of each of their responsibilities under the Plan. Nothing herein is intended, nor shall it be construed to operate as an admission of any liability for any claim or potential claim against any of the foregoing parties, the same being expressly denied; and any and all defenses thereto are expressly reserved. |
| Notice Confirming Plan<br><br>Entered 04/13/15 | 4. Discharge, Release, Injunction and Related Provisions. By the Confirmation Order, the Court has approved certain discharge, release, injunction and related provisions in Article IX of the Plan, except as set forth therein and in Docket Entry No. 782. Please note that the text of the Confirmation Order differs from the proposed order. By Docket Entry No. 782, the Court did not approve those proposed release, injunction and exculpation provisions in Article IX of the Plan that relate to (a) claims held by a non-debtor third party against another non-debtor third party (third party releases) and (b) claims held by the debtors or non-debtor third parties against professionals and other fiduciaries of the bankruptcy estate, such as directors and officers of the Debtors (exculpations). The Court severed those non-debtor third-party provisions from the other confirmation issues so that the Court could confirm the Plan, while also reserving authority to modify the proposed release, injunction and exculpation provisions. The releases set forth in Section 9.3 of the Plan have been further modified by the Amended Confirmation Order, specifically with respect to releases in favor of the Plan Contributor, Blink Acquisition, LLC and Car Charging Group, Inc., among others, which such releases shall become effective only upon the full and final satisfaction of any and all of each of those releasees' responsibilities and obligations under the Plan |

# TO TILL OR NOT TO TILL:

## CRAMDOWN INTEREST RATES FOR SECURED CREDITORS IN CHAPTER 11

September 1, 2015

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In order for a plan of reorganization to "cram down" secured debt, the proposed plan treatment must be required "fair and equitable" pursuant to 11 U.S.C. § 1129(b). Specifically, with respect to a secured creditor, at a minimum, the creditor must retain the liens securing its claim and the creditor must receive deferred cash payments with a present value at least equal to the value of its claim. 11 U.S.C. § 1129(b)(2)(A)(i)(I) and (II). Deferred cash payments to an impaired class must be valued as of the effective date of the plan and must "consist of an appropriate interest rate and an amortization of the principal which constitutes the secure claim." *In re VDG Chicken, LLC*, 2011 WL 3299089 *7 (9th Cir. BAP 2011). The question thus arises: what is an "appropriate interest rate" in the context of a cramdown?

Prior to 2004, bankruptcy courts used a variety of approaches to determine the appropriate interest rate in a cramdown situation. These approaches included: (1) the "cost of funds approach" which set the rate at the lender's cost of funds; (2) the formula method, which started with the risk-free rate and then adjusted for risk; (3) the contract approach, which applied the pre-petition rate (or the contractual default rate) agreed to by the debtor and the lender, and (4) the "coerced loan" approach which applied the market rate for loans made under similar circumstances to similar borrowers.

Then, in 2004, the Supreme Court addressed the appropriate cramdown interest rate in a chapter 13 case in which the debtor was attempting to cramdown a $4000 car loan. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004). In a plurality decision, the Supreme Court rejected the coerced loan, presumptive contract rate, and cost of funds approaches. *Id.* at 477. According to the Court, each of these approaches is "complicated, imposes significant evidentiary costs, and aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value." *Id.* The plurality then determined that the appropriate methodology for determining the interest rate on a cramdown note in a chapter 13 case was the "formula approach." *Id.* at 478-79. Per the Supreme Court, the formula approach starts with a standard measure of risk free lending, such as the Prime Rate, and adds an upward adjustment based on the debtor, the plan and the security for the loan. *Id.* Finally, the Court noted that bankruptcy court have generally approved an adjustment between 1 to 3%, and that while the Court was not issuing an opinion on an appropriate adjustment, bankruptcy courts must "select a rate high enough to compensate the creditor for its risk but not so high as to doom the plan." *Id.* at 480. Indeed, "if the court determines that the likelihood of default is so high as to necessitate an "eye-popping" interest rate, the plan probably should not be confirmed." *Id.* at 481.

Because the chapter 13 cramdown provision (11 U.S.C. § 1325(a)(5)(B)) is substantially identical to the one in chapter 11 (11 U.S.C. § 1129(b)(2)(A)(i)), it would seem to be a simple proposition that the *Till* "formula approach" should apply to chapter 11 as well. However, the Supreme Court left this issue open. In footnote 14 of *Till*, the plurality determined that the interest rate analysis in a chapter 11 might be different because there was a "free market of willing cramdown lenders," in which case, "it might make sense to ask what rate an efficient market would produce." 541 U.S. at 477, n.14.

Thus, in the years since *Till* was decided, bankruptcy courts have grappled with the Supreme Court's decision and its implications in a chapter 11 setting. Although some bankruptcy courts have declined to use the "formula approach" in chapter 11, *Till* appears to be becoming the default position for cramdown interest rates in a chapter 11 setting. *See, e.g., In re SW Boston Hotel Venture, LLC*, 460 B.R. 38 (Bankr. D. Mass. 2011), aff'd, 748 F. 3rd 393 (1st Cir. 2014) (court gives great weight to the debtor's expert's adjustments under *Till* and criticizes the bank's expert for doing no *Till* analysis); *In re South Canaan Cellular Inv., Inc.*, 427 B.R. 44

(Bankr.E.D. Penn. 2010) (discounting lender's testimony regarding market rate of 10% and adopting debtor's *Till* rate of 6%); *In re Red Mountain Mach. Co.*, 2011 WL 1428266 (Bankr.D.Ariz. 2011) (declining to utilize lender's blended market rate of 8.5-10.5 % and adopting the debtor's formula rate of 6.5%).

Courts adopt *Till* under the rationale that the Supreme Court's reasoning is "persuasive" and, moreover, the use of a *Till* formula is unlikely to be overturned on appeal. For example, the Fifth Circuit recently noted that *Till*, as a plurality opinion, is not binding and that bankruptcy court are not bound to a specific methodology in determining a cramdown interest rate. *In re Texas Grand Prairie Hotel Realty, LLC*, 710 F.3d 324, 333 (5th Cir. 2013). Nonetheless, the Fifth Circuit then held that the bankruptcy court's use of the *Till* formula approach was not clear error even though the lender claimed that use of the formula led to an "absurd" result. *See also SE Property Holdings, LLC v. Seaside Engineering & Surveying, Inc.*, *(In re Seaside Engineering & Surveying, Inc.)*, 780 F.3d 1070, 1083 (11th Cir. 2015) (bankruptcy court's use of *Till* formula approach was not clear error); *US Bank, N.A. v. Wilmington Savings Fund Society (In re MPM Silicones, LLC)*, 531 B.R. 321 (S.D.N.Y. 2015) (affirming bankruptcy court's use of *Till* formula approach in chapter 11 setting based upon Supreme Court's reasoning in *Till* and Second Circuit's earlier adoption of the formula approach).

So how does the *Till* analysis work in chapter 11? Footnote 14 in the *Till* decision seems to require the bankruptcy court to first determine if there is an efficient market for a comparable secured loan so that a market rate can be utilized for cramdown purposes. The most recent trend is for bankruptcy courts to hold that (notwithstanding the *Till* footnote) there is *no* efficient market for a cramdown loan. *See In re Texas Grand Prairie Hotel Realty, LLC*, 710 F.3d 324, 333 (5th Cir. 2013) ("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 cramdown loan exists, courts almost invariably conclude that such markets are absent" citing cases); *see also In re Rocky Mountain Land Company LLC*, 2014 WL 1338292 * 9 (Bankr.D.Colo. 2014) (finding no efficient market existed for cramdown loans); *Pineda Grantor Trust II v. Dunlap Oil Company, Inc (In re Dunlap Oil Co Inc.)*, 2014 WL 6883069 * (9th Cir. BAP 2014) (bankruptcy court did not err in applying *Till* after first finding no efficient market).

Then, once the bankruptcy court determines there is no market, the court goes back to the formula approach from *Till* to determine the appropriate "risk adjustment." In determining the appropriate "risk adjustment" courts look to the following factors:

(i) the nature of the collateral, including age, depreciation, location and condition;

(ii) the financial and general circumstances of the debtor and its estate;

(iii) the feasibility of the proposed chapter 11 plan, including adequacy of capital, current and future business operations and financial *pro formas*, management and economic conditions;

(iv) the duration of the plan or the note to be issued under the plan;

(v) the size of the equity cushion, if any;

(vi) the loan to value ratio; and

(vii) the debtor's or the collateral's cash flow.

A consideration of most or all of these factors, and more depending on the endemic risks associated with the debtor's business operations, is essential for the court to assess the appropriate risk premium. *See In re Walkabout Creek Ltd. Dividend Housing Ass'n*, 460 B.R. 567, 578 (Bankr.D.Col. 2011) (arriving at cramdown rate of 5.24% by adjusting the 30-year treasury rate upwards by 1% to account for risk, for costs of administration, for the provision for payment of interest only for the first three years of the plan, and for the 35-year period of the plan versus the 30-year treasury period); *In re Red Mountain Mach. Co*., 448 B.R. 1, 12-13 (Bankr.D.Ariz. 2011) (6.5% interest rate appropriate given debtor's improving operations and positive cash flow in each year of projections, EBITDA more than sufficient to cover debt service, positive debt service coverage ratios, significant capital expenditures provided in the budget, significant projected amortization, near term reduction in competition and a solvent guarantor).

Accordingly, "among the courts that follow *Till*'s formula method in the chapter 11 context, "risk adjustment" calculations generally range between 1% to 3% above the prime rate." *In re Rocky Mountain Land Company LLC*, 2014 WL 1338292 * 8 (Bankr.D.Colo. 2014); *see also Pamplico*, 468 B.R. at 794 ("[T]he general consensus among courts is that a one to three percent adjustment to the prime rate is appropriate, with a 1.00% adjustment representing a low risk debtor and a 3.00% adjustment representing a high risk debtor"); *In re Lilo Props.,* 2011 WL 5509401 *2 (Bankr.D.Vt. 2011) ("The Court starts with the premise that the lowest risk debtors would pay prime plus 1% and the highest rate debtors would pay prime plus 3%.) However, bankruptcy courts do tinker with this formula by either making a greater or lesser "risk adjustment" or by starting with a different base than the prime rate. *See Rocky Mountain Land*, 2014 WL at * 9 (ultimately adopting a rate of prime plus 3.75%); *In re SCC Kyle Partners, Ltd.*, 2013 WL 2903453 (Bankr.W.D.Tex. 2013) (same); *In re GAC Storage Lansing, LLC*, 485 B.R. 174, (Bankr.N.D.Ill. 2013) (adopting a rate of prime plus 5.35%); *US Bank, N.A. v. Wilmington Savings Fund Society (In re MPM Silicones, LLC)*, 531 B.R. 321 (S.D.N.Y. 2015) (affirming use of 7-year treasury rate as opposed to prime rate for baseline upon which to make the risk adjustment).

Finally, in order for a bankruptcy judge to quantify the appropriate 1-3% "risk adjustment" expert testimony will be needed. At least one court recognized the danger of a bankruptcy court attempting to calculate the necessary adjustment *without* an expert's analysis:

> Necessarily, under the Till formula approach, a bankruptcy judge might look to the real world of market rates and attempt to divine what part of market rates represents a risk premium component, but market rates of interest are not nicely broken down in the Wall Street Journal as to their various components for such things as risk, transaction costs, costs of administration, and profit. In many cases, bankruptcy judges probably mouth the words of Till regarding risk factors and after addressing those factors act as though they have the expertise to quantify a risk premium based on those factors just because Till suggests that they do, and because they are obedient soldiers in the field struggling to obey the Court's precedent. At some point, a case will arise in which, after reviewing the various risk factors a plan presents, and without any expert testimony as to the components (including the risk component) of market rates of interest or other expert testimony regarding quantifying a risk component, a judge will arrive at a risk premium adjustment that is necessarily guesswork. In such a case, a litigant might well remark that the bankruptcy judge is engaged in a naked exercise, unsupported by any evidence, of pulling a number out of thin air, and state the equivalent of "The emperor has no clothes."

*In re Walkabout Creek Ltd. Dividend Housing Ass'n*, 460 B.R. 567, 578 (Bankr.D.Col. 2011). The question thus arises as to what is a *Till* expert? Other than in a cramdown fight in a chapter 11 bankruptcy proceeding, when is an analyst ever required to create a "risk adjustment" interest rate broke down into component parts? What methodology is used to create the "risk adjustment"? How does one become a *Till* expert other than proffering *Till* opinions to a court? Moreover, in opining as to a Till adjustment, the expert should give a rationale for each adjustment. *In re Rocky Mountain Land*, 2014 WL 1338292 (Bankr. D. Colo. 2014) (relying on the expert's testimony to determine lack of efficient market and as a foundation for the Court's Till adjustments); *In re 20 Bayard Views, LLC*, 445 B.R. 83, 113 (Bankr.E.D.N.Y. 2011) (refusing to confirm plan with prime plus 1.5% interest rate as that rate did not adequately account for risks associated with the plan which include 100% loan to value, and the potential threat of the debtor's default).

Finally, In December 2014, the American Bankruptcy Institute issued its Final Report and Recommendations of the Commission to Study the Reform of Chapter 11. One of the commission's recommendations is a change in how cramdown interest rates are determined. "The Commission's recommendation rejects applying the Till formula to chapter 11 cases and adopts a general market-based approach. The Commission believes this approach best satisfies the purpose of section 1129(b)(2)(A)(i)." Specifically, the Commission concluded that "a bankruptcy court should set the cramdown interest rate based on the cost of capital for similar debt issued to companies comparable to the debtor as a reorganized entity. If however, a market rate cannot be determined for a particular debtor, the court should use a risk-adjusted rate that reflects the actual risk posed in the case of reorganized debtor, considering factors such as the debtor's industry, projections, leverage, revised capital structure and plan obligations." It, of course, remains to be seen whether Congress will adopt the Commission's recommendations. Until then, *Till* remains the persuasive authority which bankruptcy courts appear more and more likely to be compelled to follow.