

Non-consensual third-party releases in Bankruptcy: A mostly-consensual first-party proposal of the Bankruptcy Section Legislative Committee’s subcommittee on third-party releases

Recent high-profile bankruptcy cases have focused attention on non-consensual third-party releases (“TPR”) in connection with plan confirmation under Chapter 11. As these cases have shown, there is a significant split of opinion among circuit courts regarding TPR. Such a circuit split could encourage forum shopping for bankruptcy cases, which creates the potential for uncertainty and disparate treatment for certain parties.

The committee believes that there are occasions in which TPR are beneficial to the reorganization of a Chapter 11 debtor, so that a blanket prohibition of such releases, as proposed in the Nondebtor Release Prohibition Act of 2021 (S. 2497, H.R. 4777), goes too far and unnecessarily removes one potential means of providing distributions to unsecured claimants in bankruptcy cases. The usefulness of TPR and related provisions such as channeling injunctions, trusts, and other claimant protections has been shown in a long line of asbestos-related cases and the codification of this practice by way of §524(g) of the Bankruptcy Code.

However, as TPR can threaten traditional notions of notice and due process and create the appearance of unfairness, and may therefore be a source of abuse, the committee believes that there should be legislation specifically codifying (a) the authority of a bankruptcy court to confirm a plan containing TPR, (b) what constitutes notice and consent for approval of TPR (and if opt outs are required), (c) the nature of the injunction and trust implementing the TPR provision, akin to §524(g), and (d) guidelines for courts to follow in considering whether to approve a plan that contains TPR. The committee proposes the following standards be included:

- (1) No party can be granted a release for any claim that could be excepted from discharge under §523 if the released party were a debtor in a bankruptcy case;

- (2) Approval of the TPR by a supermajority of claimants, in amount and number, in the bankruptcy case whose rights would be impacted by the releases;
- (3) Specific findings of fact by the bankruptcy court that the TPR is narrow and essential to the reorganization of the debtor;
- (4) Specific findings of fact that the released non-debtors are providing substantial value to the reorganized debtor in exchange for the contemplated TPR;
- (5) Sworn financial disclosures from the non-debtors being released to show that financial contributions are reasonable under the circumstances;
- (6) A finding by the Court that the claimants affected by TPR would be better served by the plan than pursuing their claims against the released non-parties, in other forums;
- (7) Approval of any plan containing TPR is reviewed by the U.S. District Court as though it were a non-core proceeding in the bankruptcy court and the effective date of the plan is stayed until all appeals are exhausted and the confirmation order is a final, nonappealable order;
and
- (8) Substantial value as used in this section shall mean either an amount sufficient to satisfy all claims of members (whether known or unknown) of the affected class for which the TPR is being granted or an amount equal to or more than a reasonable person would expect to recover from such person were such person to seek protection under Title 11 of the United States Code.