What Are a Disclosure Statement and a Plan, and What Are the Key Elements of These Documents?

A disclosure statement and a plan are critical documents in Chapter 11 cases, representing the culmination of a case and a roadmap of the debtor's path forward. A Chapter 11 plan can be either a plan of reorganization, pursuant to which a debtor emerges from bankruptcy as a new, reorganized entity, or a plan of liquidation, pursuant to which a debtor's remaining assets are liquidated and the proceeds are distributed to creditors. Plans of liquidation are common in Chapter 11 cases, where the debtor sells substantially all of its assets. A plan outlines how creditor claims will be paid and, in the case of plans of reorganization, provide that a debtor is discharged from its prior debts through treatment of those claims under the terms laid out in the plan.

As a part of the confirmation process, certain creditors are given the opportunity to vote to accept or reject the plan — acceptance of the plan by at least one class of impaired creditors (*i.e.*, creditors who will receive less than full payment of their claims under the plan) is required for a plan to be confirmed by a bankruptcy court. A disclosure statement is a document that provides a summary of the plan, highlighting its key terms so that creditors can make an informed decision on whether to vote to accept or reject the plan. A disclosure statement must provide "adequate information" on the plan to be approved by a bankruptcy court and sent to creditors.

Disclosure statements and plans contain considerable information, and which issues are most pressing for a given creditor will depend upon the nature of that creditor's claim and its relationship with the debtor on a case-by-case basis. Below are three common key creditor issues that arise in connection with plan confirmation.

Key Issues

- **Treatment of Claims.** A debtor's plan and disclosure statement provide information on how creditor claims will be treated. Plans group similar claims into classes — claims within the same class will receive the same treatment. A plan will describe what will be provided to creditors in a given class on account of their claims. Creditor recoveries can take many forms, such as a pro rata share of a lump sum set aside to pay a certain class of creditors, recovery on certain causes of action to be pursued by a plan administrator or trustee after the plan is effective, equity in a reorganized debtor, or a release of that creditor from potential causes of action held by the debtor (*e.g.*, a release from future preference claims). Occasionally, a creditor's recovery under a plan may depend on the outcome of certain key events in a case. For example, the debtor may be at a crossroads between a reorganization of its business or the sale of its business to a buyer — the plan may provide for one form of recovery to creditors if there is a reorganization and a different form of recovery if there is a sale. Similarly, a creditor's claim may be treated differently if the creditor votes to accept the plan or reject the plan, with superior treatment granted to creditors who vote to accept. Disclosure statements often provide estimated percentage recoveries, though these estimates should be taken for what they are — a debtor's best guess of future recoveries — and far from a guarantee.

- **Third Party Releases.** Plans often contain "third-party releases," which provide releases to specified nondebtor third parties from all holders of claims against the debtor. The scope of such third-party releases can be immensely broad, both in terms of the parties giving and receiving the release, and in terms of the claims that fall within the scope of the release. For example, a plan might define "released parties" to capture a long list of third parties, along with their affiliates, directors and officers, advisors, and others. Likewise, a plan might define "releasing parties" to include all creditors, including a similarly wide host of parties affiliated with or related to those creditors. Along the same lines, a third-party release might be massive in scope, encompassing contingent claims, unknown claims, etc.

  Debtors normally include some form of opt-out mechanism or opt-in mechanism, where the ballots on which creditors vote to accept or reject a plan will also include a question asking whether the creditor wishes to opt out of or opt into a plan's third-party release. Information about these voting mechanisms is typically included within a disclosure statement. It is critical that creditors carefully review these ballots, as decisions on voting or improperly filling out a ballot can have unintended consequences. For example, if a creditor fails to submit a ballot when a plan has an opt-out mechanism for a third-party release, that creditor may be deemed to have consented to giving the release by virtue of not opting out. Likewise, a plan may provide that only creditors who vote to reject the plan or abstain from voting on the plan can opt out of a third-party release, but creditors who vote to accept are deemed to consent to the release. Finally, some plans may provide benefits for those creditors who affirmatively opt in or decline to opt out of a third-party release — for example, some plans provide that creditors who consent to the third-party release are themselves a released party under that release, or are granted some other benefit.

Nonconsensual third-party releases — where creditors have no choice but to grant a release to nondebtors under the plan — are highly controversial (and, indeed, the subject of a pending Supreme Court decision) and could be a basis for objecting to a plan.

- **Treatment of Executory Contracts or Unexpired Leases.** Creditors that have a contract or lease with the debtor will want to pay close attention to how a plan treats "executory contracts" (*i.e.*, contracts where there are material outstanding obligations for both the creditor and debtor) or unexpired leases. Plans — and supplements filed to plans — will often provide a list of contracts and leases that the debtors intend to assume or reject in connection with plan confirmation. Often, plans will provide for a blanket assumption or rejection of executory contracts not otherwise dealt with under the plan or a prior motion, and such assumption or rejection automatically occurs upon the plan's effective date. Contract or lease counterparties should carefully review any list of assumed or rejected contracts and leases, as well as the provisions of a plan dealing with contracts and leases to see if their contract or lease is being assumed or rejected. Generally speaking, if a contract or lease is being assumed, the debtor is either planning on continuing business with the counterparty or assigning its rights in that contract or lease to another party (often a buyer of the debtor's assets). Assumption requires that a debtor cure all past defaults and that the debtor (or assignee) provide adequate assurance of future performance under the contract. The amount the debtor proposes to pay to cure defaults under a contract it is assuming is usually set out in a list filed with the court, to which parties are given a short period of time to object. If they do not object in a timely manner, that amount becomes binding on the contract counterparty. If a debtor is rejecting a contract or lease, this gives rise to a "rejection damages claim," which must be timely filed in order to be processed. A creditor's rights, regarding a debtor's proposed assumption or rejection of a contract is a detailed and nuanced topic in its own right, and is addressed in other articles in the Creditor's Rights Toolkit series.

Takeaway

Disclosure statements and plans are among the most important aspects of a Chapter 11 bankruptcy. They are also complex, detailed pleadings that can give rise to a myriad of important issues for creditors. It is vital to have experienced bankruptcy counsel who can guide you through how a debtor's proposed bankruptcy plan impacts you. They can advise on the best course of action for protecting your rights as a creditor and maximizing your recovery in a Chapter 11 case.