

CREDITOR'S RIGHTS TOOLKIT

What Types of Releases Are Contained in a Chapter 11 Plan, and Do I Have to Agree to Them?

Chapter 11 plans often contain various releases — some in favor of the debtor and some in favor of certain nondebtor third parties. However, while creditors are bound by a Chapter 11 discharge, creditors have options for how to deal with a plan's third-party release.

Key Issues

CHAPTER 11 DISCHARGE

While not styled as a “release,” many Chapter 11 plans provide for the discharge of all or most of a debtor's past debts. A Chapter 11 discharge exists as a tool to provide a debtor a fresh start. Creditors do not have the ability to opt out of granting the debtor a discharge. However, to preserve their claims against the debtor, creditors should be sure to file a proof of claim for any pre-petition or post-petition claims they may hold against the debtor before the applicable bar dates in the bankruptcy case. By timely filing claims in the bankruptcy case, creditors ensure that their claims are given applicable treatment under the plan (e.g., payment for some or all of such claims) in exchange for the discharge of such claims.

THIRD PARTY RELEASES

Chapter 11 plans often contain releases of third-party, nondebtors. These “third-party releases” have been a hot topic in the bankruptcy world for years and were recently the subject of a Supreme Court ruling (see *Purdue Pharma L.P.*, 603 U.S. ____ (2024)). Courts agree that third-party releases are binding on those creditors and equity holders that consent to such releases but disagree on what constitutes consent.

- **Understanding Who Is Being Released and for What.** Third-party releases are generally very broad — typically benefitting key parties in the bankruptcy case (e.g., key lenders, the creditors' committee, and its members) and a wide host of affiliated parties. Some third-party releases cover only claims and causes of action related to the Chapter 11 case or the debtor's pre-petition conduct, while others are simply a broad release of virtually all claims. It is vital to review the plan's release language — as well as key definitions like “released party” and “releasing party” — to understand who is giving the third-party release, who benefits from such a release, and what claims are captured in the third-party release.

- **Benefit or Consequences of Not Agreeing to the Third-Party Release.** Occasionally, a creditor may actually benefit from receiving a third-party release. For example, in some Chapter 11 plans, a creditor may receive superior treatment under a plan if it consents to the third-party release contained therein, often in the form of a larger distribution. Typically, third-party releases are structured so that (apart from certain key parties) only those creditors who elect to grant the third-party release will also receive the benefit of the third-party release. If, for example, the third-party release encompasses preference actions and a creditor received significant payments from the debtor within the 90 days before bankruptcy, that creditor may prefer to consent to giving the third-party release so that it is released from potentially significant preference exposure. On the other hand, often there is no benefit to a creditor to granting the third-party release, in which case the creditor may wish to withhold consent to such release.
- **Opt-Out or Opt-In Procedures.** After evaluating whether or not to consent to granting a third-party release, creditors should carefully review the procedures for either opting out of the third-party release or opting in. Plans will either allow creditors to opt-out of a third-party release or (less commonly) to opt-in to the third-party release. This is typically done either through the submission of a ballot to vote on a plan (if the creditor is entitled to vote) or on a separate opt-out or out-in form (if the creditor is not entitled to vote). It is vital for a creditor to know the opt-out or opt-in deadline, understand how the ballot or release form works, and know the process through which such ballot or form is submitted to ensure that the creditor's decision on the third-party release is effectuated. Failure to follow the procedure correctly will result in the plan's default option (often a grant of the release) being applied to the creditor.

Takeaway

Releases in Chapter 11 plans are a complex topic. It is important that creditors retain experienced bankruptcy counsel who can help to ensure the creditor's rights are protected, including evaluating if and how to consent to a plan's third-party release.