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Chapter 11 Plan Protections and Third-Party Releases

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CHAPTER 11 PLAN PROTECTIONS AND THIRD-PARTY RELEASES*

A debtor's ability to obtain a fresh start is the defining characteristic of the bankruptcy process, and chapter 11 in particular. From the debtor's perspective, confirmation of a chapter 11 plan acts as a discharge of debts arising before confirmation, and parties are enjoined from violating the "discharge injunction" that becomes effective upon confirmation of a chapter 11 plan.[1]

But a "discharge injunction" often falls short of providing the necessary protections that a complex chapter 11 debtor will need to obtain a true "fresh start." To achieve these additional layers of protection, chapter 11 plans often include a variety of provisions that most commonly take the form of: (i) direct releases by the debtor or its estate; (ii) direct exculpations of third parties; and (iii) indirect releases of third parties.

This article and the accompanying appendix seek to clarify the distinctions between, and demystify the controversy that often surrounds, each type of relief. Particular attention is given to the most controversial of these protections – third-party releases – and the differing treatment of such provisions among the federal circuit courts of appeals and the most popular chapter 11 venues.

I. Estate Releases

Debtor or estate releases are releases provided by the debtor and its estate of claims against specified non-debtor third parties. Estate releases are the least controversial of the plan protections discussed in this article because (i) the debtor is extinguishing its own claims and (ii) estate releases are specifically authorized by the Bankruptcy Code.[2] Estate releases are typically given as consideration for concessions made by the released parties pursuant to a plan.[3]

In considering the appropriateness of such releases, courts in the Fifth Circuit generally consider whether the release is (a) "fair and equitable" and (b) "in the best interests of the estate."[4]

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[1] 11 U.S.C. § 1141(d)(1)(A) ("Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan discharges the debtor from any debt that arose before the date of such confirmation. . . . ."); *see also* 11 U.S.C. § 524(a) (imposing the "discharge injunction" to enforce the discharge effectuated upon the confirmation of a chapter 11 plan).

[2] 11 U.S.C. § 1123(b)(3)(A) (stating that a chapter 11 plan may "provide for the settlement or adjustment of any claim or interest belonging to the debtor or to the estate").

[3] *See, e.g.*, *In re Bigler LP*, 442 B.R. 537, 547 (Bankr. S.D. Tex. 2010); *In re Heritage Org., LLC*, 375 B.R. 230, 259 (Bankr. N.D. Tex. 2007); *In re Mirant Corp.*, 348 B.R. 725, 737–39 (Bankr. N.D. Tex. 2006); *In re Gen. Homes Corp.*, 134 B.R. 853, 861 (Bankr. S.D. Tex. 1991).

[4] *In re Mirant Corp.*, 348 B.R. at 738; *see also In re Heritage Org.*, 375 B.R. at 259.

Fair and equitable. Courts typically interpret the "fair and equitable" prong consistent with that term's usage in section 1129(b) of the Bankruptcy Code, to require compliance with the Bankruptcy Code's absolute priority rule.[5]

Best interests of the estate. Courts typically apply the standard for approving settlements pursuant to Bankruptcy Rule 9019 when analyzing whether a release is in the "best interests of the estate."[6]

Courts generally afford debtors discretion in determining whether granting estate releases is appropriate,[7] and estate releases will be approved unless the decision to settle estate claims falls below the lowest point in the range of reasonableness.[8]

II. Exculpation Clauses[9]

Exculpation clauses are not full-fledged releases *per se*; rather, exculpations establish a standard of care for claims held by the debtor or non-debtor third parties against professionals and other estate fiduciaries, such as official committees, their members and the debtor's directors and officers.[10] Exculpations are typically limited in scope and time to actions taken in connection with the chapter 11 case and do not extend to unrelated pre-petition conduct.[11] Exculpations almost always contain a carve-out for gross negligence and willful misconduct.[12] Moreover, while traditionally limited to estate fiduciaries, there appears to be a recent trend of extending exculpations to non-estate fiduciaries that meaningfully contribute to the chapter 11 case.[13]

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[5] *In re Mirant Corp.*, 348 B.R. at 738.

[6] *Id*. at 739–40 (citing *Official Comm. of Unsecured Creditors v. Cajun Elec. Power Coop., Inc. (In re Cajun Elec. Power Coop., Inc.)*, 119 F.3d 349, 355–56 (5th Cir. 1997)).

[7] *See Gen. Homes Corp.*, 134 B.R. at 861 ("The court concludes that such a release is within the discretion of the Debtor.").

[8] *See, e.g., In re Am. Cartage, Inc.*, 656 F.3d 82, 91 (1st Cir. 2011); *In re Energy Co-op, Inc.*, 886 F.2d 921, 929 (7th Cir. 1989); *In re W.T. Grant Co.*, 699 F.2d 599, 608 (2d Cir. 1983), *cert. denied*, 464 U.S. 822 (1983); *In re W.R. Grace & Co.*, 475 B.R. 34 (D. Del. 2012).

[9] The statements made in the following section are liberally taken from Judge Jernigan's bench ruling made in connection with confirmation of the chapter 11 plan solicited in *In re Highland Capital Mgmt., L.P.*, Case No. 19-34054 (Bankr. N.D. Tex. Feb. 9, 2021) [Docket No. 1917].

[10] *See, e.g.*, *In re PWS Holding Corp.*, 228 F.3d 224, 245 (3d Cir. 2000) (holding that an exculpation provision "is apparently a commonplace provision in Chapter 11 plans, [and] does not affect the liability of these parties, but rather states the standard of liability under the Code.").

[11] *See In re GenesisHealth Ventures, Inc.*, 266 B.R. 591, 606-07 (Bankr. D. Del. 2001), *appeal dismissed*, 280 B.R. 339 (D. Del. 2002) (declining to approve exculpation clause to the extent it covered prepetition conduct); *In re Exide Techs.*, 303 B.R. 48, 74 (Bankr. D. Del. 2003) (same); *but see In re Murray Metallurgical Coal Holdings, LLC*, 623 B.R. 444 (Bankr. S.D. Ohio 2021) (noting it was appropriate for an exculpation to cover prepetition acts such as the negotiation of DIP financing or a restructuring support agreement among a debtor and its stakeholders).

[12] *See, e.g.*, *PWS Holding Corp.*, 228 F.3d at 246 (explaining the universal formulation of exculpation clauses carving out willful misconduct and gross negligence); *In re Wash. Mut., Inc.*, 442 B.R. 314, 350-51 (Bankr. D. Del. 2011).

[13] *In re Astria Health*, 623 B.R. 793 (Bankr. E.D. Wash. 2021) (holding that an exculpation may properly be applied to non-estate fiduciaries and to postpetition acts or omissions taken in connection with the bankruptcy case); *In re Southern Foods Grp., LLC*, No. 19-36313 (DRJ) (Bankr. S.D. Tex. Mar. 17, 2021) (explaining that exculpation

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