

2019

## Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law

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### Recommended Citation

Dorothy Coco, *Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law*, 88 Fordham L. Rev. 231 (2019).

Available at: <https://ir.lawnet.fordham.edu/flr/vol88/iss1/6>

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# THIRD-PARTY BANKRUPTCY RELEASES: AN ANALYSIS OF CONSENT THROUGH THE LENSES OF DUE PROCESS AND CONTRACT LAW

Dorothy Coco\*

*Bankruptcy courts disagree on the use of third-party releases in Chapter 11 bankruptcy plans, the different factors that circuit courts consider when deciding whether to approve a third-party release, and the impact of the various consent definitions on whether a release is or should be binding on the creditor. Affirmative consent, “deemed consent,” and silence are important elements in this discussion. Both contract law and due process provide lenses to evaluate consent definitions to determine whether nondebtor third-party releases should bind certain creditor groups. This Note proposes a solution that follows an affirmative consent approach to protect against due process violations and promote consistency across bankruptcy courts.*

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#### INTRODUCTION

Courts have difficulty applying a consistent standard for what constitutes consent in third-party releases in Chapter 11 bankruptcy plan confirmations. Chapter 11 refers to business reorganizations that typically propose a plan to keep the business functioning both during and after the bankruptcy.<sup>1</sup> A Chapter 11 plan is a court-ordered agreement that satisfies the various statutory requirements set out in the U.S. Bankruptcy Code (“the Code”) and lays out the treatment of the debtor’s obligations with respect to each class of creditors and interest holders.<sup>2</sup> A third-party release allows a debtor to extend a release to a nondebtor party<sup>3</sup> who participates in or impacts the debtor’s ability to reorganize.<sup>4</sup> Courts generally approve nondebtor third-party releases as binding on creditors in Chapter 11 cases when there is

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1. See John M. Czarnetzky, *Time, Uncertainty, and the Law of Corporate Reorganizations*, 67 *FORDHAM L. REV.* 2939, 2974 (1999) (“The congressional vision for a chapter 11 case is for the parties to negotiate a consensual, binding plan of reorganization that preserves the corporation’s ‘going concern’ value, defined as the value of the corporation above its liquidation value.”); *Chapter 11—Bankruptcy Basics*, U.S. CTS., <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics> [<https://perma.cc/6VBM-2BG7>] (last visited Aug. 22, 2019); see also 16 RICHARD LEVIN & HENRY J. SOMMER, *COLLIER ON BANKRUPTCY* § 21.11 (16th ed. 2019).

2. See LEVIN & SOMMER, *supra* note 1, § 21.11; see also *Chapter 11—Bankruptcy Basics*, *supra* note 1.

3. “A debtor might seek to extend third party releases to co-debtors, officers, directors, lenders, parents, guarantors, sureties, or insurance carriers where those parties could assert post-confirmation indemnification claims against the debtor, or where the non-debtor party is a potential source of funding for the plan of reorganization.” Michael S. Etkin & Nicole M. Brown, *Third Party Releases?—Not So Fast! Changing Trends and Heightened Scrutiny*, 29 *AIRA J.*, no. 3, 2015, at 22, 22.

4. See *id.*; see also Victoria Vron, *Court Denies Plan Confirmation over Impermissible Third-Party Releases*, WEIL BANKR. BLOG (Oct. 21, 2010), <https://business-finance-restructuring.weil.com/releases-exculpations/court-denies-plan-confirmation-over-impermissible-third-party-releases/> [[perma.cc/B5YW-W5L6](https://perma.cc/B5YW-W5L6)] (“Some debtors may include third-party releases in a chapter 11 plan with the mindset that there is no harm asking for the third-party releases—if the court does not approve such releases, the court will just confirm the plan without them.”).

obvious affirmative consent where creditors opt in to the release;<sup>5</sup> however, in situations without explicit creditor consent, approval occurs only in limited or extraordinary circumstances.<sup>6</sup>

Situations where an express response from creditors is not present or required are controversial, as what constitutes “deemed” or implied consent varies across courts.<sup>7</sup> This Note examines statutes, cases, contract law, and constitutional principles to help define consent in the bankruptcy release context.<sup>8</sup> Differing opinions regarding consent requirements within judicial districts and across circuits leads to inconsistent application of the Code and differing results depending on the filing location.<sup>9</sup> Some of these cases purport to bind creditors despite the absence of clear approval for such a release and thus raise due process concerns. Inconsistent interpretations of the Code, as well as differing requirements for approving third-party releases, may lead to forum shopping. The enforcement and permissibility of a release may depend on the “luck of the draw” in terms of the assigned judge.<sup>10</sup> For example, there is no consensus even among judges within the Southern District of New York or the District of Delaware—both of which frequently hear large, high-profile Chapter 11 cases.<sup>11</sup>

This Note examines the various definitions of consent utilized in bankruptcy reorganizations and the potential due process violations

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5. See, e.g., *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017).

6. William P. Weintraub, *Permissibility of Third-Party Releases in Non-Asbestos Cases*, 32 REV. BANKING & FIN. SERVICES 137, 137 (2016).

7. See *infra* Part II.B.

8. Some believe the problems surrounding third-party releases stem from statutory conflicts regarding the permissibility of such releases and court perceptions of how those statutes interact. See Etkin & Brown, *supra* note 3, at 22.

9. See Samuel Schwartz & Kristina Perez, *3rd-Party Releases Bring Chapter 11 Venue Considerations*, LAW360 (Nov. 13, 2018, 4:31 PM), <https://www.law360.com/articles/1101522/3rd-party-releases-bring-chapter-11-venue-considerations> [<https://perma.cc/EF3B-BR6N>]; see also Jill B. Bienstock, *Recent SDNY Decision Adds to the Fray: When Do Courts Approve Non-Consensual Releases?*, COLE SCHOTZ P.C. (June 3, 2019), <https://www.csbankruptcyblog.com/2019/06/articles/bankruptcy/recent-sdny-decision-adds-to-the-fray-when-can-courts-approve-non-consensual-releases/> [<https://perma.cc/QJ7R-74QD>].

10. “[B]ankruptcy practitioners should heavily vet where they file bankruptcy cases, especially if they know third-party, nondebtors releases may be necessary to confirm the Chapter 11 plan.” Schwartz & Perez, *supra* note 9.

11. Jay M. Goffman & George N. Panagakis, *Trends in Chapter 11 Filings, Venue and Proposed Reforms*, SKADDEN (Jan. 2015), <https://www.skadden.com/insights/publications/2015/01/trends-in-chapter-11-filings-venue-and-proposed-re> [<https://perma.cc/XYJ4-8KDF>] (“The District of Delaware and the Southern District of New York attracted more than 14 percent of all 2014 corporate bankruptcy cases filed (measured as of the end of September 2014) and 17 percent of all such cases filed since 2001. These jurisdictions have received an even larger share of large public company Chapter 11 filings. Since 1980, 36 percent of such cases have been filed in the District of Delaware and 20 percent have been filed in the Southern District of New York. By comparison, the next most-frequent venue (the Northern District of Texas) accounted for less than 4 percent of all large public company filings during the same period. These venue trends have intensified in recent years, with the District of Delaware and the Southern District of New York attracting more than 75 percent of large public company filings since 2010.”); see also *In re Aegean Marine Petroleum Network Inc.*, 599 B.R. 717, 726 (Bankr. S.D.N.Y. 2019) (“Almost every proposed Chapter 11 Plan that I receive includes proposed releases.”).

associated with third-party releases. This Note proposes a solution to reduce inconsistency in support of clearer affirmative consent requirements.

Part I of this Note distinguishes consensual and nonconsensual third-party releases used in some Chapter 11 plans and discusses the split within districts and across circuits prompted by this distinction. Part I also examines the potential due process violations that may result from the treatment of creditors or claimholders purportedly bound to such plans. Part II analyzes various courts' differing definitions of consent—affirmative consent, deemed consent, and silence—and explores the due process concerns surrounding both the relinquishment of claims and the applied consent definition. Part III proposes a standard that courts and practitioners could use when deciding whether to approve or create a plan. This Note concludes that creditors should give affirmative consent for a court to bind them to a third-party release. An affirmative consent requirement for third-party releases would protect creditors' due process rights.

#### I. THE WHO, WHAT, WHERE, AND WHY OF THIRD-PARTY RELEASES

Chapter 11 of the Bankruptcy Code enables the reorganization of a corporation's finances and operations. This reorganization often allows a business to continue running while paying its creditors over time.<sup>12</sup> Third-party releases are used when a debtor seeks to extinguish claims,<sup>13</sup> or rights of payment, held between two nondebtor parties through confirmation of a Chapter 11 plan<sup>14</sup>:

[A] release may seek to cover the debtor's directors and officers, an unsecured creditors' committee and its members, a nondebtor plan proponent, a plan sponsor, the debtor's lenders and their agents, and other parties who may have been actively engaged in the chapter 11 case and perhaps made contributions to the process.<sup>15</sup>

The plan of reorganization is a highly negotiated, multiparty contract between the debtor and its body of creditors and any other equity interests

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12. *Chapter 11—Bankruptcy Basics*, *supra* note 1. Individuals can also file under Chapter 11. See 11 U.S.C. § 109(d) (2012); *Chapter 11—Bankruptcy Basics*, *supra* note 1. There are specific criteria for whether a corporation, company, or individual qualifies for a Chapter 11 bankruptcy. See *Chapter 11—Bankruptcy Basics*, *supra* note 1.

13. In the Bankruptcy Code, a claim is defined as a:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5) (2012).

14. AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11 253 (2014), <https://abiworld.app.box.com/s/vvircv5xv83aav14dp4h> [perma.cc/DHC6-ZYZB]; see also Van C. Durrer II et al., *Overview of ABI Commission Report and Recommendation on the Reform of Chapter 11 of the Bankruptcy Code*, SKADDEN 11–12 (Dec. 23, 2014), <https://www.skadden.com/insights/publications/2014/12/overview-of-abi-commission-report-and-recommendati> [perma.cc/2U4F-PLCN].

15. AM. BANKR. INST., *supra* note 14, at 253.

that are not terminated under law.<sup>16</sup> A debtor is a person or entity that files for bankruptcy looking to be discharged from debt.<sup>17</sup> A creditor is an entity that holds a claim against the debtor that arises before the debtor files for bankruptcy.<sup>18</sup> Debtors often utilize third-party releases to incentivize parties to support a plan or to influence others to contribute to and fund the plan.<sup>19</sup> Nondebtor third parties under Chapter 11 are often insiders of the debtor—such as directors and officers—as well as the debtor’s insurers or major plan contributors.<sup>20</sup>

For a court to approve a debtor’s plan of reorganization—a necessary step for the debtor to exit bankruptcy successfully—there must be at least one impaired class of creditors that accepts the plan.<sup>21</sup> Impairment is narrowly defined; any change of a creditor’s rights against a debtor is viewed as an impairment of a creditor’s claim.<sup>22</sup> On the other hand, unimpaired creditor claims are those unaltered and unaffected under the proposed plan.<sup>23</sup> Each unimpaired creditor receives exactly what it would have received had the debtor-business or debtor-individual not filed for bankruptcy.<sup>24</sup> This distinction is important because only impaired creditors have the right to vote on a plan.<sup>25</sup> Unimpaired creditors are conclusively presumed to favor the plan and do not vote on the plan.<sup>26</sup> Unimpaired creditors retain their monetary claim against the debtor and all rights of collection and enforcement that are related to that claim.<sup>27</sup> From the perspective of an

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16. Czarnetzky, *supra* note 1, at 2975 n.218 (“[C]hapter 11 is based on a model of flexibility, open bargaining, and freedom of contract. The basic premise is that the stakeholders in the reorganization are free to carve up reorganization value in whatever manner they see fit.” (quoting CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 824 (1997))).

17. *See* 11 U.S.C. § 101(13).

18. *Id.* § 101(10).

19. AM. BANKR. INST., *supra* note 14, at 255 (“A debtor may need the assistance of nondebtor parties to effect its reorganization. This assistance may be in the form of service, collaboration, funding, business commitments, or other means that allow the debtor to achieve its objectives in the chapter 11 case or in its postconfirmation operations. Nondebtor parties may be reluctant to contribute to the plan or the debtor’s reorganization efforts if the nondebtor party might be exposed to liability or will have ongoing liability despite confirmation of the chapter 11 plan.”).

20. *See, e.g.*, SEC v. Drexel Burnham Lambert Grp., Inc. (*In re* Drexel Burnham Lambert Grp., Inc.), 960 F.2d 285, 293 (2d Cir. 1992) (allowing releases of most of the securities claims asserted against the debtor’s directors and officers); *see also* Etkin & Brown, *supra* note 3, at 22.

21. *See* 11 U.S.C. § 1124.

22. *See* 7 LEVIN & SOMMER, *supra* note 1, ¶ 1124.03. A creditor’s claim is impaired if the proposed plan changes the original debt terms, such as reducing the interest rate or lengthening the pay-out period. *Id.* Impairment happens even if the debt arrangement terms are improved. *Id.* Examples include a decrease in the payback period or an increase in paid interest. *Id.* ¶ 1124.03[5].

23. *See* 11 U.S.C. § 1124(1); 7 LEVIN & SOMMER, *supra* note 1, ¶ 1124.03.

24. *See* 11 U.S.C. § 1124(1); 7 LEVIN & SOMMER, *supra* note 1, ¶¶ 1124.02–1124.03.

25. *See* 11 U.S.C. § 1124; 7 LEVIN & SOMMER, *supra* note 1, ¶ 1124.03.

26. *See* 11 U.S.C. §§ 1124(1), 1126(f); 7 LEVIN & SOMMER, *supra* note 1, ¶¶ 1124.02–1124.03.

27. *See* 11 U.S.C. § 1124(1); 7 LEVIN & SOMMER, *supra* note 1, ¶ 1124.03.

unimpaired creditor, it is as if the bankruptcy never happened as they get all that was owed to them.

While holders of unimpaired claims are typically deemed to have consented to the plan,<sup>28</sup> courts disagree about whether a third-party release really leaves a creditor unimpaired.<sup>29</sup> A release relieves or waives the nondebtor parties of liability for some specified claims and causes of action that third parties may hold against them.<sup>30</sup> A release is defined as a relinquishment of a right, title, or claim.<sup>31</sup>

A Chapter 11 plan can only be confirmed if the court finds that the plan complies with the entire Bankruptcy Code.<sup>32</sup> Controversy surrounds the permissibility and use of third-party releases, as various courts draw opposite conclusions interpreting different sections of the Bankruptcy Code, particularly §§ 524(e) and 105(a). Section 524(e) states that the discharge of a debtor's debt cannot affect other parties' liability.<sup>33</sup> Section 105(a) grants bankruptcy judges broad equitable powers to take actions that are necessary to implement the Bankruptcy Code.<sup>34</sup> Once a plan is confirmed, the plan and all of its provisions bind the debtor, creditors,<sup>35</sup> and any other related entities that benefit or are connected to the plan, regardless of impairment status or whether the entity had voted to accept or reject the plan.<sup>36</sup>

Part I.A explores the minority view that disapproves of third-party releases, whether consensual or nonconsensual, and claims that the Code prohibits this practice. Part I.B lays out the majority view that approves of third-party consensual releases, at least in certain circumstances. Part I.C examines the Seventh Circuit's view that third-party releases are permissible

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28. 8 LEVIN & SOMMER, *supra* note 1, ¶ 1141.02[5][b].

29. Part II.A.3 discusses courts' mixed responses regarding whether an otherwise unimpaired creditor becomes impaired if the creditor is forced to release a claim.

30. AM. BANKR. INST., *supra* note 14, at 255.

31. *Release*, BLACK'S LAW DICTIONARY (10th ed. 2014). Releases come up in a Chapter 11 confirmation plan, disclosure statement, and in the Bankruptcy Code. *See* 11 U.S.C. § 727(a) (explaining that "[t]he court shall grant the debtor a discharge, unless [an exception applies]"); 11 U.S.C. § 1141(d)(1) (explaining that "the confirmation of a plan discharges the debtor from any debt that arose before the date of [the] confirmation"); *see also infra* notes 40–43.

32. 11 U.S.C. § 1129(a)(1).

33. 11 U.S.C. § 524(e); *see infra* notes 44–45 and accompanying text. Some courts have interpreted § 524(e) as a prohibition against nonconsensual third-party releases. *See, e.g.,* Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc.), 885 F.2d 621, 626 (9th Cir. 1989); *see also infra* Part I.A.

34. 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the 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.").

35. Creditors within a plan are not all equal and will be separated into classes to vote on the plan. 11 U.S.C. § 1123(a)(1).

36. AM. BANKR. INST., *supra* note 14, at 253 n.913; *see also* Sharon L. Levin et al., *The WaMu Lesson: Craft Your Releases Carefully*, LAW360 (Jan. 28, 2011, 1:04 PM), <https://www.law360.com/articles/222713/the-wamu-lesson-craft-your-releases-carefully> [perma.cc/LBL2-YNVT] (discussing the rejection of the releases in *In re Washington Mutual, Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011)).

regardless of consent. Part I.D showcases the various standards that the bankruptcy courts in different circuits use to determine the appropriateness of the third-party release. Part I.E examines the rules surrounding clear and conspicuous disclosure utilized in reorganizations that can be applied to releases. Part I.F examines the connection between contract law and third-party releases. Finally, Part I.G examines the Due Process Clause and the potential violations associated with certain third-party releases in situations without affirmative consent.

#### A. *Minority View of Third-Party Releases*

Third-party releases are controversial because the Bankruptcy Code does not explicitly authorize them—other than in asbestos cases.<sup>37</sup> Circuits are split on whether bankruptcy courts are empowered to grant such releases, consensual or otherwise, outside of asbestos cases.<sup>38</sup> This controversy is greatest in relation to nonconsensual releases because the strongest statutory authority for court approval of a release rests on the notion that bankruptcy courts have inherent jurisdiction to settle cases and enforce contracts that are necessary to complete a bankruptcy case;<sup>39</sup> however, where the release is nonconsensual, it is difficult to locate the contract at issue.

Courts differ in opinion on more than the breadth of the equitable authority granted under § 105; they also differ on how to construe § 524(e). The

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37. See 11 U.S.C. § 524(g)(1)(B); see also Chelsea Ireland, *Discharging the Debt of a Third-Party Non-Debtor Is Within the Authority of the Bankruptcy Courts*, PROC. N.Y.U. MOOT CT. BOARD (Dec. 2, 2017), <https://proceedings.nyumootcourt.org/2017/12/discharging-the-debt-of-a-third-party-non-debtor-is-within-the-authority-of-the-bankruptcy-courts/> [perma.cc/FR9N-Y3A4] (“[T]he requirements laid out in § 524(g) are indicative of the need for a clear and specific process for organizing and overseeing asbestos cases, rather than of Congress’s intention to drastically narrow the circumstances under which a third-party discharge could be used. The inclusion of a third-party discharge . . . under § 524(g) was therefore not meant to impose any additional restrictions on the bankruptcy courts . . .”).

38. “The nub of the circuits’ disagreement concerns . . . whether § 524(e) . . . bars a bankruptcy court from releasing non-debtors from liability to a creditor without the creditor’s consent.” *Airadigm Commc’ns, Inc. v. FCC* (*In re Airadigm Commc’ns, Inc.*), 519 F.3d 640, 656 (7th Cir. 2008) (finding that § 524(e) bars third-party releases); *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 142 (2d Cir. 2005) (finding that § 524(e) does not bar third-party releases).

39. For examples of such statutory authority, see 11 U.S.C. §§ 105, 524, 1126–1129, 1141–1142.



minority of circuit courts, which includes the Fifth,<sup>40</sup> Ninth,<sup>41</sup> and Tenth<sup>42</sup> Circuits, hold that § 524(e) prohibits third-party releases.<sup>43</sup> Section 524(e) provides that the “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,”<sup>44</sup> and these courts view third-party releases as the contractual equivalent of a debtor-discharge, which releases the nondebtor entities from liabilities.<sup>45</sup>

Because the minority view finds third-party releases impermissible under the Code, there are no discussions in these circuits regarding consent to decide whether to bind creditors to a third-party release—they are not bound because the release cannot be used.

40. The Fifth Circuit specifically rejects a bankruptcy court’s authority to confirm third-party releases on the basis that the releases have consequences not intended by Congress. *Bank of N.Y. Tr. Co. v. Official Unsecured Creditors’ Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009); *Feld v. Zale Corp. (In re Zale Corp.)*, 62 F.3d 746, 761 (5th Cir. 1995) (holding that a bankruptcy court cannot approve third-party releases because approval exceeds its powers under § 105; such authority would incentivize those who would receive a release to push debtors into bankruptcy); *see also* Victoria Vron, *The Future of Third-Party Releases and Exculpations: A Look at the Fifth Circuit*, WEIL BANKR. BLOG (Oct. 8, 2010), <https://business-finance-restructuring.weil.com/releases-exculpations/the-future-of-third-party-releases-and-exculpations-a-look-at-the-fifth-circuit/> [perma.cc/4CTA-RCEZ] (analyzing the Fifth Circuit’s *Pacific Lumber* decision).

41. *Resorts Int’l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401–02 (9th Cir. 1995) (holding that third-party releases violate § 524(e)); *Am. Hardwoods, Inc. v. Deutsche Credit Corp. (In re Am. Hardwoods, Inc.)*, 885 F.2d 621, 626 (9th Cir. 1989) (holding that § 524(e) limits the court’s equitable power under § 105 to order the discharge of nondebtor liabilities); *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985) (“[T]he bankruptcy court has no power to discharge the liabilities of a nondebtor pursuant to the consent of creditors as part of a reorganization plan.”).

42. *Lansing Diversified Props.-II v. First Nat’l Bank & Tr. Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 600 (10th Cir. 1990) (“Congress did not intend to extend such [discharge] benefits to third-party bystanders.”); *In re Midway Gold US, Inc.*, 575 B.R. 475, 505–06 (Bankr. D. Colo. 2017) (holding that, although the Tenth Circuit does not forbid third-party releases in Chapter 11 plans, the bankruptcy court lacked jurisdiction to adjudicate releases of claims against nondebtors as the underlying claims should not be considered part of the proceedings to confirm the plan and are not within its “core” or “related to” jurisdiction).

43. The actual language of § 524(e) does not expressly reference third-party releases. These circuits believe that third-party releases are prohibited even if all creditors consent. *See* Peter M. Boyle, Note, *Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy*, 61 FORDHAM L. REV. 421, 428 (1992). Mr. Boyle concludes that third-party releases violate “the express command of section 524” and are “contrary to public policy.” *Id.* at 450.

44. 11 U.S.C. § 524(e).

45. Courts that follow the minority view find that the discharge of the debtor’s pre-confirmation debts via the Code should not affect another entity’s liability. Kathrine A. McLendon & Lily Picón, *The Changing Landscape of Consensual Third-Party Releases in Chapter 11 Plans: Does Silence = Consent?*, HARV. L. SCH.: BANKR. ROUNDTABLE (May 7, 2018), <http://blogs.harvard.edu/bankruptcyroundtable/files/2018/05/The-Changing-Landscape-of-Consensual-Third-Party-Releases-in-Chapter-11-Plans.pdf> [perma.cc/83S3-C46N]; *see also* AM. BANKR. INST., *supra* note 14, at 254.

*B. Majority View of Third-Party Releases*

Consensual releases involve a creditor who either affirmatively consents or is deemed to consent to the third-party release.<sup>46</sup> Releases may be coupled with a reorganization plan and become enforceable based on general contract law principles.<sup>47</sup>

The Bankruptcy Code does not directly state whether a third-party release requires express consent; nevertheless, courts evaluate consent when determining whether releases are permissible or should be approved.<sup>48</sup> Additionally, consent is not defined in the Code in the context of third-party releases, and courts inconsistently determine what qualifies as consent.<sup>49</sup>

In *In re Millennium Lab Holdings II, LLC*,<sup>50</sup> Judge Laurie Selber Silverstein of the Bankruptcy Court for the District of Delaware held that bankruptcy courts have constitutional authority to grant third-party releases in a confirmation order regardless of creditor consent.<sup>51</sup> This authority is rooted in the idea that bankruptcy judges are constitutionally permitted to enter final confirmation orders; therefore, they are authorized to approve a plan containing a third-party release because the releases are part of the plan confirmation.<sup>52</sup>

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46. *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017) (“Courts generally agree that an affirmative vote to accept a plan that contains a third-party release constitutes an express consent to the release.”); see also Brad B. Erens, *Second and Seventh Circuits Issue Decisions on Third-Party Releases*, JONES DAY: INSIGHTS (May/June 2008), <https://www.jonesday.com/Second-and-Seventh-Circuits-Issue-Decisions-on-Third-Party-Releases-06-01-2008/#> [perma.cc/8AU9-JCMX] (“Most courts do not find voluntary third-party releases controversial, since they essentially represent an agreement between the creditor and the released nondebtor party.”).

47. *In re SunEdison*, 576 B.R. at 458 (first citing *In re Neogenix Oncology, Inc.*, No. 12-23557, 2015 WL 5786345, at \*5 (Bankr. D. Md. Oct. 1, 2015); then citing *In re Wash. Mut., Inc.*, 442 B.R. 314, 352 (Bankr. D. Del. 2011)) (“Courts generally apply contract principles in deciding whether a creditor consents to a third-party release.”); see *infra* note 208 and accompanying text. Voting to accept the plan may count as acceptance of a proposed release provision contained in it, but a release may be enforceable in other instances as well. See *infra* Part II (discussing instances where courts consider acceptance).

48. *In re Nickels Midway Pier, LLC*, No. 03-49462 (GMB), 2010 WL 2034542, at \*13 (Bankr. D.N.J. May 21, 2010); *In re Zenith Elecs. Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999).

49. See *infra* Part II (discussing the various consent definitions that different courts have applied).

50. 575 B.R. 252 (Bankr. D. Del. 2017), *aff’d sub nom.* *Opt-Out Lenders v. Millennium Lab Holdings II, LLC* (*In re Millennium Lab Holdings II, LLC*) 591 B.R. 559 (D. Del. 2018).

51. *Id.* at 274; see also *Opt-Out Lenders v. Millennium Lab Holdings II, LLC* (*In re Millennium Lab Holdings II, LLC*), 591 B.R. 559, 586 (D. Del. 2018); Jeff Montgomery, *Trustee Objects to Takata’s Ch. 11 Liability Releases*, LAW360 (Jan. 31, 2018, 8:24 PM), <https://www.law360.com/articles/1007790/trustee-objects-to-takata-s-ch-11-liability-releases> [perma.cc/EUN4-BY26].

52. See *In re Millennium Lab Holdings II*, 575 B.R. at 265–79; Matt Chiappardi, *3rd-Party Release Constitutional*, Millennium Labs *Judge Says*, LAW360 (Oct. 3, 2017, 9:21 PM), <https://www.law360.com/articles/971044/3rd-party-release-constitutional-millennium-labs-judge-says> [perma.cc/2QUG-9Q6K]; Matthew Kelsey, J. Eric Wise & Matthew Porcelli, *A Tale of 2 Cases on 3rd-Party Releases*, LAW360 (Nov. 9, 2017, 5:43 PM), <https://www.law360.com/articles/984058/a-tale-of-2-cases-on-3rd-party-releases> [https://perma.cc/E5EC-H5K7]. While *Millennium Lab II* is in conflict with *Washington Mutual*, the

A majority of circuit courts, which includes the Second,<sup>53</sup> Third,<sup>54</sup> Fourth,<sup>55</sup> Sixth,<sup>56</sup> Seventh,<sup>57</sup> and Eleventh<sup>58</sup> Circuits, hold that enforcement of consensual third-party releases is permissible in appropriate, limited circumstances<sup>59</sup> if certain factors exist<sup>60</sup> and that enforcement of nonconsensual releases should only be permitted in unusual circumstances.<sup>61</sup>

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Third Circuit denied the petition for appeal to rule on the difference. *See In re Millennium Lab Holdings*, No. 16–8017, 2016 U.S. App. LEXIS 20441 (3d Cir. Feb. 24, 2016) (denying petition to appeal); *infra* notes 157–58 and accompanying text; *see also* Marion M. Quirk & Jonathan A. Grasso, Millennium Lab, *Update on Non-Debtor Third-Party Releases*, COLE SCHOTZ P.C. (Oct. 11, 2016), <https://www.csbankruptcyblog.com/2016/10/articles/bankruptcy/millennium-lab-update-non-debtor-third-party-releases/> [perma.cc/WS76-XGH8].

53. *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 143 (2d Cir. 2005) (holding that, to confirm a Chapter 11 plan containing a nondebtor release, the release had to be important and necessary to the plan); *SEC v. Drexel Burnham Lambert Grp., Inc.* (*In re Drexel Burnham Lambert Grp., Inc.*), 960 F.2d 285, 293 (2d Cir. 1992) (holding that releases of third parties may be approved if found to play an important role in the plan).

54. *Gillman v. Cont'l Airlines* (*In re Cont'l Airlines*), 203 F.3d 203, 212–14 (3d Cir. 2000) (holding that nonconsensual third-party releases should be granted only in extraordinary cases and evidence is needed that shows the release was necessary and fair).

55. *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 694, 702 (4th Cir. 1989) (holding that § 524(e) must not be applied literally to prohibit bankruptcy courts from approving a third-party release); *see Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 347 (4th Cir. 2014) (confirming that third-party releases are permissible in appropriate circumstances but denying them because the *Dow Corning* factors were not met); *see also* Christopher Hopkins, *The Fourth Circuit Provides a Useful Roadmap for Debtors Seeking Third-Party Releases*, WEIL BANKR. BLOG (July 17, 2014), <https://business-finance-restructuring.weil.com/releases-exculpations/the-fourth-circuit-provides-a-useful-roadmap-for-debtors-seeking-third-party-releases/> [https://perma.cc/8RL8-MFW3] (“[C]ourts will not simply ‘rubber stamp’ third-party releases absent creditor consent unless the debtor is able to prove that the unique circumstances of the case justify the release.”).

56. *Class Five Nev. Claimants (00-2516) v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 656–57 (6th Cir. 2002) (holding that § 524(e) merely “explains the effect of a debtor’s discharge” and “does not prohibit the release of a non-debtor”).

57. *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047 (7th Cir. 1993) (“[A] per se rule disfavoring all releases in a reorganization plan would be . . . unwarranted, if not a misreading of [§ 524(e)].”).

58. *SE Prop. Holdings, LLC v. Seaside Eng’g & Surveying, Inc.* (*In re Seaside Eng’g & Surveying, Inc.*), 780 F.3d 1070, 1079 (11th Cir. 2015) (approving third-party releases using the *Dow Corning* factors and noting that the factors are nonexclusive and not all must be satisfied).

59. Most courts acknowledge that third-party releases are an exception, not a rule. *See, e.g., Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc.* (*In re Metromedia Fiber Network, Inc.*), 416 F.3d 136, 141 (2d Cir. 2005) (holding that third-party releases are allowed but recognizing that “it is clear that such a release is proper in only rare cases”); *In re Dow Corning Corp.*, 280 F.3d at 657–58 (noting that third-party releases are “a dramatic measure to be used cautiously”); *In re Cont'l Airlines*, 203 F.3d at 212–13 (recognizing that third-party releases have only been approved in “extraordinary cases”); *In re Transit Grp., Inc.*, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002) (“In addition, the courts allowing non-debtor releases hold that the granting of such releases is justified only in unusual circumstances. Routine inclusion of nondebtor releases is not appropriate.”).

60. *See infra* Part I.C (discussing the various factor breakdowns by circuit).

61. The circuit split between the majority and minority views has grown over the decades. *See Boyle, supra* note 43 (providing a pre-1992 analysis of the interpretations of third-party releases).

While the First and Eighth Circuits have yet to decide on the permissibility of third-party releases, lower courts in both the First<sup>62</sup> and Eighth<sup>63</sup> Circuits have indicated agreement with the majority view.

The majority of circuits find the releases permissible by relying on the equitable powers granted to bankruptcy courts under § 105(a) of the Code.<sup>64</sup> The majority holds that § 105(a) grants bankruptcy courts the authority to approve nondebtor releases under appropriate circumstances due to the equitable powers available to the bankruptcy courts.<sup>65</sup> These courts consider the permissibility of a particular release through case-specific inquiries of consensual determinations and application of the circuit standards for release usage and approval.<sup>66</sup> Furthermore, the majority rejects the minority's notion that § 524(e) prohibits bankruptcy courts from approving plans with third-party releases on the grounds that § 524(e) merely explains the effect of a debtor's discharge and does not prohibit the release of a nondebtor through some means other than a discharge.<sup>67</sup>

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62. See *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 983–84 (1st Cir. 1995) (expressing no view on the applicability and acceptance of third-party releases). Within the First Circuit, bankruptcy courts find jurisdiction to confirm plans that include third-party releases but state that the ability should be exercised with restraint. See, e.g., *In re Grove Instruments, Inc.*, 573 B.R. 307, 314 (Bankr. D. Mass. 2017); *In re Charles St. African Methodist Episcopal Church of Bos.*, 499 B.R. 66, 100–02 (Bankr. D. Mass. 2013) (finding jurisdiction and authority to enter an order releasing third-party claims); *In re Quincy Med. Ctr., Inc.*, No. 11-16394, 2011 WL 5592907, at \*2–4 (Bankr. D. Mass. Nov. 16, 2011) (holding that the court had jurisdiction to enter an order releasing third-party claims, but it needed the affected parties' consent); *In re Mahoney Hawkes, LLP*, 289 B.R. 285, 297–300 (Bankr. D. Mass. 2002) (recognizing court authority for approving third-party releases).

63. *In re U.S. Fidelis, Inc.*, 481 B.R. 503, 519 (Bankr. E.D. Mo. 2012) (“[T]he court may confirm a plan that includes compelled releases of non-debtors . . . . [I]f exceptional circumstances exist, the releases are widely supported by the creditor constituency (including those creditors who will be restrained), the constituency to be restrained receives significant benefits, and the creditors as a whole are being treated fairly.”).

64. *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc.* (*In re Seaside Eng'g & Surveying, Inc.*), 780 F.3d 1070, 1076 (11th Cir. 2015); *Class Five Nev. Claimants (00-2516) v. Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 656 (6th Cir. 2002); *Gillman v. Cont'l Airlines* (*In re Cont'l Airlines*), 203 F.3d 203, 211 (3d Cir. 2000); *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047 (7th Cir. 1993); *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 694, 701 (4th Cir. 1989); *MacArthur Co. v. Johns-Manville Corp.* (*In re Johns-Manville Corp.*), 837 F.2d 89, 93 (2d Cir. 1988).

65. See generally Jason W. Harbour & Tara L. Elgie, *Fourth Circuit Declines to Adopt Blanket Rule Against Nonconsensual Nondebtor Releases*, AM. BANKR. INST. J., Mar. 2012, at 65. The pro-release courts sometimes point to § 1123(b)(6) and Federal Rule of Bankruptcy Procedure 3016(c) to show congressional intent to support using third-party releases. See, e.g., *Airadigm Commc'ns, Inc. v. FCC* (*In re Airadigm Commc'ns, Inc.*), 519 F.3d 640, 657 (7th Cir. 2008); *Bank of N.Y., Mellon Tr. Co. v. Becker* (*In re Lower Bucks Hosp.*), 488 B.R. 303, 318–19 (Bankr. E.D. Pa. 2013); *In re Gen. Growth Props. Inc.*, No. 09-11977, 2010 Bankr. LEXIS 5689, at \*10 (Bankr. S.D.N.Y. Jan. 20, 2010).

66. AM. BANKR. INST., *supra* note 14, at 254.

67. See, e.g., *Behrmann v. Nat'l Heritage Found., Inc.*, 663 F.3d 704, 710 (4th Cir. 2011) (citing *In re A.H. Robins Co.*, 880 F.2d at 701); see also *In re Airadigm Commc'ns, Inc.*, 519 F.3d at 656–57; *In re Dow Corning Corp.*, 280 F.3d at 657–58; *Stuart, L.L.C. v. First Mount Vernon Indus. Loan Ass'n* (*In re Peramco Int'l, Inc.*), 3 F. App'x 38, 42 (4th Cir. 2001); *SEC v. Drexel Burnham Lambert Grp., Inc.* (*In re Drexel Burnham Lambert Grp., Inc.*), 960 F.2d 285, 293 (2d Cir. 1992).

C. *Seventh Circuit Anomaly: Consent Determination Is Unnecessary*

The Seventh Circuit reads the Code provisions differently than the other circuit courts of appeals, but its reading appears to be a variation on the majority view's statutory analysis. It views third-party releases as entirely acceptable where appropriate or necessary, with or without consent, and bases this reading on the equitable authority granted to bankruptcy courts in § 105(a) and the broad language of § 1123(b)(6).<sup>68</sup> The Seventh Circuit believes a bankruptcy court's powers are not limited when deciding whether to grant a nondebtor third-party release in a bankruptcy plan confirmation.<sup>69</sup>

Reaching out to an additional provision of the Code, the Seventh Circuit roots its reasoning for permissibility in § 1123(b) rather than in just §§ 105 and 524(e). This is consistent with the U.S. Supreme Court's opinion in *Law v. Siegel*,<sup>70</sup> which stated that § 105(a) does not permit bankruptcy courts to deviate from or act in contravention of other sections of the Code.<sup>71</sup> Section 1123(b)(6) permits a court to "include any other appropriate provision not inconsistent with [the Bankruptcy Code]."<sup>72</sup> The Seventh Circuit does not view § 524(e) as banning third-party releases or § 105 as explicitly permitting them;<sup>73</sup> rather, § 524(e) merely "limits the operation of other parts of the bankruptcy code and preserves rights that might otherwise be construed as lost after the reorganization."<sup>74</sup> The Seventh Circuit held, "where Congress has limited the powers of the bankruptcy court, it has done so clearly . . . by expressly limiting the court's power."<sup>75</sup> Therefore, the Seventh Circuit construes the broad language of authority in § 105(a) along with § 1123(b)(6) to ultimately approve of third-party releases.

D. *Judicial Standards Used to Determine Whether to Approve a Third-Party Release*

In circuits where third-party releases are permissible, various standards are followed to determine approval of such releases. Courts lay out limited

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68. *In re Airadigm Commc'ns, Inc.*, 519 F.3d at 657. The Seventh Circuit stated that determining appropriateness is fact intensive, case specific, and depends on the nature of the reorganization. *Id.* The third-party release must (1) be narrowly tailored, (2) not constitute a "blanket immunity," and (3) be essential to the debtor's reorganization. *Id.*

69. *Id.* at 656–57 (first citing *Pepper v. Litton*, 308 U.S. 295, 304 (1939); then citing *United States v. Energy Res. Co., Inc.*, 495 U.S. 545, 549 (1990)). A bankruptcy court applies the principles and rules of equity jurisprudence, and those equitable powers are traditionally broad. *Id.* "Section 105(a) codifies this understanding of the bankruptcy court's powers by giving it the authority to effect any 'necessary or appropriate' order to carry out the provisions of the bankruptcy code." *Id.*; see also 11 U.S.C. § 105(a) (2012). A bankruptcy court is also able to "exercise these broad equitable powers within the plans of reorganization themselves." *In re Airadigm Commc'ns, Inc.*, 519 F.3d at 657; see also 11 U.S.C. § 105(a).

70. 571 U.S. 415 (2014).

71. *Id.* at 421–22.

72. *In re Airadigm Commc'ns, Inc.*, 519 F.3d at 657 (citing 11 U.S.C. § 1123(b)(6) (2006)).

73. *Id.* at 656 (citing *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047 (7th Cir. 1993)).

74. *In re Specialty Equip.*, 3 F.3d at 1047; see also *In re Hunter*, 970 F.2d 299, 311 (7th Cir. 1992).

75. *In re Airadigm Commc'ns, Inc.*, 519 F.3d at 656 (citing 11 U.S.C. § 105(b) (2006)).

circumstances for approval of third-party releases to prevent abuse of the bankruptcy process.<sup>76</sup>

The Second Circuit considers the following factors found in *In re Metromedia Fiber Network, Inc.*<sup>77</sup>: (1) whether the estate has received a substantial contribution; (2) whether the enjoined claims are channeled into a settlement fund rather than extinguished; (3) whether the enjoined claims would indirectly impact the debtor's reorganization through claims of indemnity or contribution; (4) whether the plan otherwise provides for payment in full of the enjoined claims; and (5) whether the creditor has consented.<sup>78</sup>

The Third Circuit follows the factors laid out in *In re Master Mortgage Investment Fund, Inc.*<sup>79</sup> and *In re Continental Airlines*.<sup>80</sup> A commission of the American Bankruptcy Institute<sup>81</sup> (ABI) recommended that all bankruptcy courts apply the “*Master Mortgage* factors,”<sup>82</sup> which lower courts already apply in the Third<sup>83</sup> and Eighth Circuits.<sup>84</sup> Those five factors consider:

- (1) the identity of interest between the debtor and the third party, usually an indemnity relationship, such that a suit against the nondebtor is, in essence, a suit against the debtor or will deplete assets of the estate;

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76. *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 142 (2d Cir. 2005) (stating that a third-party release “lends itself to abuse” because it effectively operates as a bankruptcy discharge without the necessity to file a bankruptcy). This fear was not unfounded. In two large mass tort cases, *In re A.H. Robins Co.*, 880 F.2d 694 (4th Cir. 1989) and *In re Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1988), allegations arose that solvent companies were inappropriately filing for Chapter 11 protection because the management wanted to limit their liability. Boyle, *supra* note 43, at 444.

77. 416 F.3d 136 (2d Cir. 2005).

78. *Id.* at 142–44.

79. 168 B.R. 930 (Bankr. W.D. Mo. 1994).

80. 203 F.3d 203 (3d Cir. 2000).

81. The ABI is an organization of judges, attorneys, professors, and accountants who specialize in bankruptcy. See AM. BANKR. INST., *supra* note 14, at 2–3. It provides reports and recommendations to Congress and the public regarding bankruptcy regulations, laws, and trends. *Id.* The ABI released a study on Chapter 11 plan practices, issuing recommendations not explicitly permitted by law. See *generally id.*

82. AM. BANKR. INST., *supra* note 14, at 256. The commission also examined the *Dow Corning* factors but ultimately decided that these factors were inadequate and picked the *Master Mortgage* factors as they “adequately capture[d] the careful review required in these cases and declined to incorporate separate identification of unique or unusual circumstances.” *Id.*; see also *In re Master Mortg. Inv. Fund*, 168 B.R. at 935 (listing the factors); *infra* notes 90–92 and accompanying text (providing the *Dow Corning* factors and analysis).

83. See *In re Wash. Mut., Inc.*, 442 B.R. 314, 349 (Bankr. D. Del. 2011); Etkin & Brown, *supra* note 3, at 24–28. Judge Brendan L. Shannon in *In re Indianapolis Downs, LLC* stated that courts in Delaware follow the *Master Mortgage* factors, sometimes called “*Zenith* factors,” in deciding whether to grant a third-party release as part of a plan. See 486 B.R. 286, 303 (Bankr. D. Del. 2013) (citing *In re Zenith Elecs. Corp.*, 241 B.R. 92, 110 (Bankr. D. Del. 1999)). However, Judge Shannon believes bankruptcy courts can take a flexible approach in determining whether third-party releases are consensual. See Christopher A. Ward & Jarrett Vine, *Delaware Opinion in Indianapolis Downs Case Expands Third Party Releases and Approves Post-Petition Lock-Up Agreements*, POLSINELLI SHUGHART (Mar. 2013), <https://sftp.polsinelli.com/publications/bankruptcy/upd0313bfr.htm> [https://perma.cc/V563-D6EM].

84. See, e.g., *In re U.S. Fidelis, Inc.* 481 B.R. 503, 518–21 (Bankr. E.D. Mo. 2012).

(2) whether the nondebtor has contributed substantial assets to the reorganization; (3) whether the injunction is essential to reorganization; (4) whether a substantial majority of the creditors agree to such injunction—specifically, whether the impacted class or classes have “overwhelmingly” voted to accept the proposed plan treatment; and (5) whether the plan provides a mechanism for the payment of all, or substantially all, of the claims of the class or classes affected by the injunction.<sup>85</sup>

The ABI preferred the *Master Mortgage* factors because all five factors captured the necessary careful review courts should undertake when considering approval of a plan containing third-party releases.<sup>86</sup> Various courts that have applied the *Master Mortgage* factors have also stated that it is not an exclusive list but rather a guide or tool in determining approval.<sup>87</sup> The “*Continental Airlines* factors,” sometimes discussed in the Third Circuit,<sup>88</sup> highlight the “hallmarks” of permissible releases in consideration of: (1) the fairness of the release, (2) whether the releases are necessary to the reorganization, and (3) whether fair consideration has been given in exchange for the release.<sup>89</sup>

The Sixth Circuit follows a different set of factors for the use of third-party releases, known as the “*Dow Corning* factors.”<sup>90</sup> This standard would approve third-party releases if:

(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.<sup>91</sup>

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85. *Id.* (citing *In re Master Mortg. Inv. Fund*, 168 B.R. at 937–38).

86. *Id.*

87. U.S. Bank Nat’l Ass’n v. Wilmington Tr. Co. (*In re Spansion, Inc.*), 426 B.R. 114, 143 n.47 (Bankr. D. Del. 2010); *In re Zenith Elecs.*, 241 B.R. at 110–11; *In re Master Mortg. Inv. Fund*, 168 B.R. at 937.

88. *See, e.g., In re Millennium Lab Holdings II, LLC*, 575 B.R. 252, 272–73 (Bankr. D. Del. 2017), *aff’d sub nom. Opt-Out Lenders v. Millennium Lab Holdings II, LLC* (*In re Millennium Lab Holdings II, LLC*), 591 B.R. 559 (D. Del. 2018).

89. *Gillman v. Cont’l Airlines* (*In re Cont’l Airlines*), 203 F.3d 203, 214 (3d Cir. 2000); *see also Vron, supra* note 4.

90. *Class Five Nev. Claimants* (00-2516) v. *Dow Corning Corp.* (*In re Dow Corning Corp.*), 280 F.3d 648, 658 (6th Cir. 2002).

91. *Id.* (first citing *Menard-Sanford v. Mabey* (*In re A.H. Robins Co.*), 880 F.2d 694, 701–02 (4th Cir. 1989); then citing *MacArthur Co. v. Johns-Manville Corp.* (*In re Johns-Manville*

The Fourth Circuit also applies the *Dow Corning* factors.<sup>92</sup>

#### E. Clear and Conspicuous Disclosure

Federal Rule of Bankruptcy Procedure 3016(c) requires specific and conspicuous language in a disclosure statement to identify all entities subject to an injunction.<sup>93</sup> Rule 2002(c)(3) requires the plan to include a statement with conspicuous language if a plan proposes an injunction, as well as a description of that injunction and those subject to said injunction.<sup>94</sup> Rule 3020(c)(1) requires the plan confirmation order to describe in reasonable detail the acts enjoined, specify the terms, and identify the entities subject to the injunction.<sup>95</sup>

The Third Circuit in *In re Lower Bucks Hospital*<sup>96</sup> rejected a third-party release because the release was not properly disclosed to the creditors or the court at the appropriate time,<sup>97</sup> as required by 11 U.S.C. § 1125(a)(1).<sup>98</sup> In addition to the third-party release being omitted from numerous sections, the court stated: “[n]o use was made of underlined, italicized or boldfaced text to emphasize the Release or to distinguish it from the more typical releases between the parties to the settlement.”<sup>99</sup>

#### F. Contract Law

Some bankruptcy courts analogize bankruptcy plans containing third-party releases to a contract that binds those who vote in favor of it.<sup>100</sup> A waiver, a common contract law concept, is a voluntary relinquishment of a known right.<sup>101</sup> The debtors and courts can potentially construe and view the plan

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Corp.), 837 F.2d 89, 92–94 (2d Cir. 1988); and then citing *In re Cont'l Airlines*, 203 F.3d at 214).

92. Nat'l Heritage Found., Inc. v. Highbourne Found., 760 F.3d 344, 348–51 (4th Cir. 2014).

93. FED. R. BANKR. P. 3016(c).

94. *Id.* r. 2002(c)(3).

95. *Id.* r. 3020(c)(1).

96. 571 F. App'x 139 (3d Cir. 2014).

97. *Id.* at 144 (“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.”); see also Adam Lavine, *Indecent Disclosure: How the Failure to Disclose a Third-Party Release Led to Its Undoing*, WEIL BANKR. BLOG (July 23, 2014), <https://business-finance-restructuring.weil.com/chapter-11-plans/indecent-disclosure-how-the-failure-to-disclose-a-third-party-release-led-to-its-undoing/> [<https://perma.cc/S97K-VLRA>].

98. Section 1125(a)(1) states: “‘adequate information’ means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor’s books and records.” 11 U.S.C. § 1125(a)(1) (2012).

99. *In re Lower Bucks Hosp.*, 571 F. App'x at 143.

100. See, e.g., *In re Coram Healthcare Corp.*, 315 B.R. 321, 336 (Bankr. D. Del. 2004); *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 506 (Bankr. D.N.J. 1997). Courts in agreement with the view that releases can be examined through the lens of contract law find that, when a third-party release is voluntary, “it is no different from any other settlement or contract.” *In re Arrowmill Dev.*, 211 B.R. at 506.

101. 8 TIMOTHY MURRAY, CORBIN ON CONTRACTS § 40.1 (rev. ed. 2019).



of reorganization as a unilateral contract.<sup>102</sup> Then, the court determines what constitutes acceptance of the unilateral offer of the plan; that acceptance is also known as consent.<sup>103</sup>

Under contract law principles, consent may be express or manifested by conduct.<sup>104</sup> “Courts generally agree that an affirmative vote to accept a plan that contains a third-party release constitutes an express consent to the release.”<sup>105</sup> This determination of acceptance is at the heart of disagreement among courts as to whether a release is consensual and, if so, how that consent is obtained.<sup>106</sup>

Contractual rights may be waived if they are knowingly, voluntarily, and intentionally relinquished.<sup>107</sup> Any competent adult can release a legal right, and once abandoned, it is gone forever.<sup>108</sup> “[S]uch abandonment ‘may be established by affirmative conduct or by failure to act so as to evince an intent not to claim a purported advantage.’”<sup>109</sup>

A waiver may be express or inferred from actions or conduct, but the facts must amount to an intentional relinquishment of a known right.<sup>110</sup> The party asserting a waiver has no requirement to show prejudice or detrimental reliance, but good faith and fair dealing are frequently associated with waiver discussions.<sup>111</sup> Issuing a waiver is “within the control of the party who chooses to relinquish” their right.<sup>112</sup> The nonconsenting creditors in the general plan—those who voted “no” on the plan’s confirmation and are still bound to the plan—ordinarily would not be bound if the plan of reorganization were just a contract because it would be viewed as a nonacceptance; they are bound, however, because bankruptcy courts have the power to bind them via the confirmation process.<sup>113</sup> If creditors receive adequate consideration for releasing their claims, courts do not typically find a problem with a release as there is a contract made amongst the relevant parties involved.<sup>114</sup>

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102. “Many courts have employed the legal precept that a . . . plan is a court-sanctioned contract that binds the . . . debtor and its creditors.” *In re Stuart*, 402 B.R. 111, 126 (Bankr. E.D. Pa. 2009) (citing *In re Harvey*, 213 F.3d 318, 321 (7th Cir. 2000)). “[I]t may be more accurate to conceptualize a . . . plan that is confirmed without debtor-creditor negotiation as a specialized type of contract—perhaps more like a unilateral contract.” *Id.* at 126 n.23.

103. *Id.*

104. *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017); RESTATEMENT (SECOND) OF CONTRACTS § 19 (AM. LAW INST. 1981).

105. *In re SunEdison*, 576 B.R. at 458 (collecting cases).

106. *See infra* Part II (discussing the various definitions of consent to a third-party release).

107. *See, e.g.*, *Parsons v. Halliburton Energy Servs.*, 785 S.E.2d 844, 851 (W. Va. 2016).

108. *McElroy v. B.F. Goodrich Co.*, 73 F.3d 722, 724 (7th Cir. 1996).

109. *Morrison v. Buffalo Bd. of Educ.*, 741 F. App’x 827, 830 (2d Cir. 2018) (quoting *Fundamental Portfolio Advisors, Inc. v. Tocqueville Asset Mgmt., L.P.*, 850 N.E.2d 653, 817 (N.Y. 2006)).

110. MURRAY, *supra* note 101, § 40.1.

111. *Id.*

112. *Id.*

113. 11 U.S.C. § 1141 (2012).

114. *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017) (first citing *In re Neogenix Oncology, Inc.*, No. 12-23557, 2015 WL 5786345, at \*5 (Bankr. D. Md. Oct. 1, 2015); then citing *In re Wash. Mut., Inc.*, 442 B.R. 314, 352 (Bankr. D. Del. 2011))

### G. The Due Process Clause

Due process questions arise when determining whether to approve third-party releases in a bankruptcy plan without consent or through implied consent. This is because the releases may deprive individuals of a fundamental right and interfere with the free exercise of the rights of individuals forced into accepting these releases.<sup>115</sup> Due process is explicitly stated in the Fifth<sup>116</sup> and Fourteenth Amendments.<sup>117</sup> The Supreme Court has interpreted the due process requirement set out in both clauses identically.<sup>118</sup> Due process has long been considered a fundamental principle of fairness.<sup>119</sup> Procedural due process demands an opportunity to be heard.<sup>120</sup> In *Board of Regents of State Colleges v. Roth*,<sup>121</sup> the Court defined the property interest protected by due process as a “legitimate claim of entitlement” to the item or benefit in question that is “defined by existing rules or understandings that stem from an independent source such as state law.”<sup>122</sup> Due process is an individual right, so all legal procedures set by statute and court practice must be followed so no prejudicial or unequal treatment results.<sup>123</sup>

To find that a due process violation exists, courts must determine if there is a deprivation of a person’s life, liberty, or property without the opportunity to be heard.<sup>124</sup> In bankruptcy third-party releases, it must be determined whether the court is unlawfully depriving such an interest via a release that

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115. *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 729 (Bankr. S.D.N.Y. 2019) (holding that the nonconsensual releases will not be approved because no proper justification was found “to take away the rights that claimants may have to pursue claims that they own directly against the officers and directors”); Transcript of Hearing at 36, *In re Cumulus Media Inc.*, No. 17-13381 (SCC) (Bankr. S.D.N.Y. Feb. 1, 2018), ECF No. 434 [hereinafter *Cumulus Transcript*] (“I’m a huge fan of due process . . . I don’t want anybody to inadvertently relinquish rights that they have and that might be meaningful to them. So I’m happy to continue the discussion at confirmation.”); see also Boyle, *supra* note 43, at 447.

116. U.S. CONST. amend. V (“No person shall be . . . deprived of life, liberty, or property, without due process of law . . .”). The Fifth Amendment applies only to the federal government.

117. U.S. CONST. amend. XIV, § 1 (“No State shall . . . deprive any person of life, liberty, or property, without due process of law . . .”). The Fourteenth Amendment applies only to states and their subdivisions.

118. Justice Felix Frankfurter explained in *Malinski v. New York*, “[t]o suppose that ‘due process of law’ meant one thing in the Fifth Amendment and another in the Fourteenth is too frivolous to require elaborate rejection.” 324 U.S. 401, 415 (1945).

119. See *Medina v. California*, 505 U.S. 437, 443 (1992); *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

120. *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965) (“A fundamental requirement of due process is ‘the opportunity to be heard.’” (quoting *Grannis v. Ordean*, 234 U.S. 385, 394 (1914))).

121. 408 U.S. 564 (1972).

122. *Id.* at 577 (holding that the plaintiff did not have a sufficient property interest for his due process right to have been violated).

123. Robert P. Capistrano, *5.1.B Express Causes of Action, Section 1983, Due Process Claims and Procedural Issues*, CLEARINGHOUSE COMMUNITY, [http://www.federalpracticemanual.org/chapter5/section1b#footnoteref1\\_1i4nzyp](http://www.federalpracticemanual.org/chapter5/section1b#footnoteref1_1i4nzyp) [<https://perma.cc/QF9E-S5KU>] (last visited Aug. 22, 2019).

124. See U.S. CONST. amend. XIV, § 1; see also *Roth*, 408 U.S. at 577.

is not expressly consensual, or even expressly nonconsensual. The Supreme Court views fundamental liberty interests as limited to rights that are “implicit in the concept of ordered liberty,” such that “neither liberty nor justice would exist if [they] were sacrificed,”<sup>125</sup> or rights that are “deeply rooted in this Nation’s history and tradition.”<sup>126</sup> The right to petition and the right to seek redress of grievances are considered guaranteed under the First Amendment.<sup>127</sup> In 1983, the Court set out the principle that “the right of access to the courts is an aspect of the First Amendment right to petition the Government for redress of grievances.”<sup>128</sup> Additionally, in 2002, the Court stated it had long viewed the right to sue in court as a form of petition.<sup>129</sup>

In third-party releases, the creditors whose claims are under consideration for release are potentially losing a legitimate claim of entitlement defined by state law and the Constitution—the right to petition.<sup>130</sup> These claims may include breach of fiduciary duty, personal injury, and torts, among other claims.<sup>131</sup> According to the Bankruptcy Code, a class of claims accepts a plan if the plan has been approved by creditors holding at least two-thirds in dollar amount and more than one-half in number of the allowed claims.<sup>132</sup> A plan is consensually confirmed if every class approves, which consequentially means up to one-third in any or every class could have voted “no” on the plan.<sup>133</sup> A class of consenting creditors that make up the majority can strip the minority of their third-party claims against their consent if the plan contains one or more third-party releases. This presents a due process

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125. *Bowers v. Hardwick*, 478 U.S. 186, 191–92 (1986) (quoting *Palko v. Connecticut*, 302 U.S. 319, 325–26 (1937)), *overruled by* *Lawrence v. Texas*, 539 U.S. 558 (2003).

126. *Moore v. City of East Cleveland*, 431 U.S. 494, 503 (1977).

127. U.S. CONST. amend. I (“Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances.”).

128. *Bill Johnson’s Rests., Inc. v. NLRB*, 461 U.S. 731, 741 (1983) (citing *Cal. Motor Transp. Co. v. Trucking Unlimited*, 404 U.S. 508, 510 (1972)).

129. *BE & K Constr. Co. v. NLRB*, 536 U.S. 516, 524–25 (2002) (“We have recognized this right to petition as one of ‘the most precious of the liberties safeguarded by the Bill of Rights’ . . . and have explained that the right is implied by ‘the very idea of a government, republican in form.’” (citations omitted) (first quoting *United Mine Workers of Am. v. Ill. Bar Ass’n*, 389 U.S. 217, 222 (1967); then quoting *United States v. Cruikshank*, 92 U.S. 542, 552 (1876))).

130. Judge Michael E. Wiles in *In re Aegean Marine Petroleum Network, Inc.* stated, “we should not lose sight of the fact that when we impose involuntary releases we do not provide claimants with other procedural and substantive rights that they ordinarily would have.” 599 B.R. 717, 725 (Bankr. S.D.N.Y. 2019); *see also In re Digital Impact, Inc.* 223 B.R. 1, 13 n.6 (Bankr. N.D. Okla. 1998) (noting that a third-party release has “the effect of a judgment—a judgment against the claimant and in favor of the non-debtor, accomplished without due process”).

131. Jason Binford, *Beware of Third-Party Releases in Bankruptcy*, HOTEL NEWS NOW (Dec. 14, 2015, 7:08 AM), <http://www.hotelnewsnow.com/Articles/28778/Beware-of-third-party-releases-in-bankruptcy> [https://perma.cc/F89K-UGVZ].

132. 11 U.S.C. §§ 1126(c)–(d), 1129 (2012). “A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan.” *Id.* § 1126(c).

133. *See id.* § 1126.

problem as the creditors are being stripped of a right. Without a requirement to opt-out of a third-party release, the dissenters are bound by the claim release even if one-third of the class votes against the plan or remains silent and less than half of the value claims also vote against it or remain silent.

According to the Supreme Court, “some form of hearing is required before an individual is finally deprived of a property interest.”<sup>134</sup> Additionally, the Court has stated that the right to be heard before suffering a loss is a basic societal principle.<sup>135</sup> The definition of that loss could perhaps include the nonconsensual loss of a contractual right or right to pursue a claim or cause of action, like those found in third-party releases.

## II. THIRD-PARTY RELEASES AND CONSENT

Determining the permissibility and scope of third-party release provisions in Chapter 11 plans is a case-specific inquiry whose outcome varies based on the jurisdiction and debtors’ circumstances.<sup>136</sup> Recent case law addresses the various outcomes as to whether third-party releases are permissible and focuses on what constitutes consent for a third-party release in different districts.<sup>137</sup> This Note discusses court opinions on whether such consent must be express rather than implied or deemed. Further, the court opinions discuss how such consent must be obtained. No clear standard exists for how courts should determine Chapter 11 creditors’ consent in a restructuring plan, which results in inconsistent application across districts and between judges within the same districts.<sup>138</sup> In some jurisdictions, creditors who do not affirmatively consent or remain silent can be bound by a release that extinguishes claims and causes of action held by and against third parties, which could potentially lead to violations of those creditors’ constitutional rights. An ABI commission recommended that third-party releases be enforceable if express consent is obtained.<sup>139</sup> Part II highlights the controversy and confusion surrounding third-party releases and the various applications of consent.

Part II.A examines the various views applied in courts surrounding affirmative consent, explicit rejection, and deemed consent. Part II.B assesses the various views that discuss silence in consent determinations when deciding whether to approve a binding release. These views vary in application both across circuits and within districts.

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134. *See, e.g.*, *Mathews v. Eldridge*, 424 U.S. 319, 333 (1976); *Wolff v. McDonnell*, 418 U.S. 539, 557–58 (1974); *Phillips v. Comm’r*, 283 U.S. 589, 596–97 (1931).

135. *Joint Anti-Fascist Refugee Comm. v. McGrath*, 341 U.S. 123, 168 (1951) (Frankfurter, J., concurring).

136. Francis J. Lawall & James C. Carignan, *Third-Party Plan Releases Require Wide Support by All Creditor Classes*, PEPPER HAMILTON LLP (Oct. 15, 2010), <https://www.pepperlaw.com/publications/third-party-plan-releases-require-wide-support-by-all-creditor-classes-2010-10-15/> [https://perma.cc/E4YS-DX5R].

137. *See supra* Parts I.A–B.

138. *See, e.g.*, McLendon & Picón, *supra* note 45; Schwartz & Perez, *supra* note 9.

139. AM. BANKR. INST., *supra* note 14, at 255.

A. *Affirmative Consent (Opt In) and Deemed Consent (Failure to Opt Out)*

Affirmative consent or rejection is typically viewed as a voluntary, express statement in support of or opposition to an action.<sup>140</sup> In the bankruptcy plan context, these can be applied through opt-in or opt-out provisions in a bankruptcy plan ballot.<sup>141</sup>

1. Must Opt In to Consent

Opting in to a third-party release is an affirmative step that enables a court to easily determine whether approval of a third-party release within the plan is truly consensual.<sup>142</sup> Yet, while opting in can provide clarity, it is not applied or required by all bankruptcy judges when approving a plan or ballot.

In *In re Chassix Holdings, Inc.*,<sup>143</sup> Judge Michael E. Wiles of the Southern District of New York set out five different categories of voting and nonvoting creditor parties and indicated whether each category had consented or could be deemed to have consented to the third-party releases.<sup>144</sup> Judge Wiles reasoned: (1) creditors who submit a ballot and vote in favor of the plan *affirmatively consent* to the release;<sup>145</sup> (2) creditors who submit a ballot and vote to reject the plan but opt in to the release *affirmatively consent* to the release;<sup>146</sup> (3) creditors who are entitled to vote but fail to return a ballot, thus abstaining from voting, do *not affirmatively consent* and are *not deemed to consent* to the release;<sup>147</sup> (4) creditors holding claims in classes “deemed to reject” the plan but who neither *affirmatively consent* nor are *deemed to consent* to the release are deemed to reject the release;<sup>148</sup> and (5) creditors holding claims that are unimpaired and are in classes deemed to accept the plan do *not affirmatively consent* and are *not deemed to consent* to the release.<sup>149</sup>

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140. 8 LEVIN & SOMMER, *supra* note 1, ¶ 1141.02[5][b].

141. *In re Chassix Holdings, Inc.*, 533 B.R. 64, 80 (Bankr. S.D.N.Y. 2015).

142. *Id.*

143. 533 B.R. 64 (Bankr. S.D.N.Y. 2015). In *Chassix*, debtors sought confirmation of a plan that included broad third-party releases and the ballot in question contained an opt-in provision so that the creditors voting could reject the plan and decide whether to release their claims if the plan was ultimately confirmed. *Id.* at 76.

144. *See id.* at 77–81.

145. *Id.* at 80.

146. *Id.*

147. *Id.* A consenting creditor includes a claimholder who voted to accept the plan or a claimholder who voted to reject the plan but *affirmatively elects* to provide releases by opting in on the ballot. *Id.* at 75. The additional step of “affirmative election” refers to checking the opt-in provision on the ballot and approving the release associated with the plan. This enabled Judge Wiles to consider the creditor to have “affirmatively consented” to the release. *Id.*

148. *Id.* at 81 (“As to creditors and interest holders who were deemed to reject the Plan (and therefore were given no opportunity to vote or to ‘opt in’ to the releases): it would defy common sense to conclude that those parties had ‘consented’ to releases.”). Judge Wiles left an opening to provide “deemed to reject” classes with a specific opt-in mechanism in future cases since he highlighted that those creditors were not given the opportunity to opt in to the release. *See id.*

149. *Id.* at 80–81.

## 2. Failure to Opt Out as Consent

Failing to opt out of a release when voting on a plan has different judicial significance and application when determining the consent connected to a third-party release.

The *Chassix* court found that compelling a creditor who is affirmatively rejecting a plan to additionally opt out of a release effectively sets a trap for inattentive creditors. If a creditor rejects the plan, it also would likely reject the third-party releases within the plan and a further opt out would be redundant.<sup>150</sup> The court viewed an affirmative opt-in vote as a way to prevent the loss a right to claims due to the voter's inattention; so, failure to additionally opt out would not be considered consent.<sup>151</sup> Therefore, if creditors vote to approve the plan, they are considered to have affirmatively consented to the third-party releases; if the creditors reject the plan, they are only bound to the third-party release if they opt in. This application of the Bankruptcy Code closely protects creditors who Judge Wiles considers impaired by the existence of third-party releases.

In *In re SunEdison, Inc.*,<sup>152</sup> Judge Stuart M. Bernstein of the Southern District of New York stated that courts typically agree that an affirmative vote to accept a plan containing a third-party release constitutes express consent to the release.<sup>153</sup> However, accepting the plan may be insufficient where the plan does not also include an option to opt out of the release.<sup>154</sup> A creditor's affirmative vote for the plan and failure to opt out where an opt-out provision is present can constitute consent for the release consistent with contract law.<sup>155</sup> Judge Bernstein highlighted *Chassix*: “[c]harging all inactive creditors with full knowledge of the scope and implications of the proposed third party releases, and implying a ‘consent’ to the third party releases based on the creditors’ inaction, is simply not realistic or fair, and would stretch the meaning of ‘consent’ beyond the breaking point.”<sup>156</sup>

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150. *See id.* at 79.

151. *See id.*

152. 576 B.R. 453 (Bankr. S.D.N.Y. 2017).

153. *Id.* at 458 (collecting cases).

154. McLendon & Picón, *supra* note 45. The *SunEdison* plan ballot did not include an opt-out provision. *In re SunEdison*, 576 B.R. at 460 n.8. While the plan originally stated the parties were to be released by “all Holders of Claims entitled to vote for or against the Plan that do not vote to reject the plan,” Judge Bernstein believed those deemed to reject the plan still need an opt-out opportunity. *Id.* at 455. “Non-voting classes deemed to reject the Plan under 11 U.S.C. § 1126(g) could not be bound by the Release. Such a provision would violate the best interest test under 11 U.S.C. § 1129(a)(7)(A)(ii) and render the Plan unconfirmable.” *Id.* at 457 n.4.

155. *See* Alexander J. Nicas, *SDNY Bankruptcy Court Rejects Non-Consensual Third-Party Releases*, KRAMER LEVIN: BROKEN BENCH BYTES (Dec. 13, 2017), <https://www.kramerlevin.com/pdf-gen/result/32873/SDNY%20Bankruptcy%20Court%20Rejects%20Non-Consensual%20Third-Party%20Releases%20.pdf> [<https://perma.cc/AUW2-MZ2L>].

156. *In re SunEdison*, 576 B.R. at 460 (citing *In re Chassix Holdings*, 533 B.R. at 81).

In *In re Washington Mutual, Inc.*,<sup>157</sup> Judge Mary F. Walrath of the District of Delaware found that the bankruptcy court could not grant a binding third-party release absent the parties' consent, which could be obtained by voting in favor of the plan and not opting out; failure to opt out was considered consent.<sup>158</sup> The third-party releases before the same judge in *In re Southeastern Grocers, LLC*<sup>159</sup> were considered consensual for: (1) holders of impaired claims or interests who were entitled to vote and accepted the plan, (2) holders of unimpaired claims who did not timely object to the releases, and (3) creditors who rejected or abstained from voting on the plan but did not indicate on their ballots an intent to opt out of the releases.<sup>160</sup>

In *In re Indianapolis Downs, LLC*,<sup>161</sup> Judge Brendan L. Shannon of the District of Delaware, after evaluating the *Master Mortgage* factors, deemed releases that included an opt-out provision consensual.<sup>162</sup> If a creditor does not directly opt out of the release, the creditor will be bound by the release if the plan is confirmed.<sup>163</sup> The opt-out approach results in third-party releases that bind (1) parties who affirmatively vote to accept the plan, (2) parties who affirmatively reject the plan and do not opt out of the release, (3) unimpaired parties who are deemed to accept the plan and the releases,<sup>164</sup> and (4) parties who are entitled to vote and abstain from both voting and opting out of the third-party release by not returning the ballot.<sup>165</sup> The only parties not bound by the third-party releases are those who opted out of the release and those who are deemed to reject the plan—all other creditors “consented” to the

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157. 442 B.R. 314 (Bankr. D. Del. 2011).

158. *Id.* at 355. The original plan in *Washington Mutual* had a problem in that it provided that the creditors who affirmatively rejected the plan's releases by opting out would still remain bound. *Id.* at 351. The debtors ultimately removed that provision as the court found it invalid. *In re Wash. Mut.*, 442 B.R. at 352. Judge Walrath noted that she had previously held that the bankruptcy court does not have the power to grant a third-party release absent consent. *Id.* at 351–52 (citing *In re Coram Healthcare Corp.*, 315 B.R. 321, 335 (Bankr. D. Del. 2004)). There exists a conflict between Judge Silverstein's opinion in *Millennium Lab Holdings II* and Judge Walrath's opinion in *Washington Mutual*, as the two cases, both in Delaware, come to differing conclusions. *Millennium Lab Holdings II* permits nonconsensual releases and *Washington Mutual* does not. *See supra* notes 50–52 and accompanying text.

159. No. 18-10700 (MFW) (Bankr. D. Del. filed Mar. 27, 2018).

160. Findings of Fact, Conclusions of Law, and Order (I) Approving Debtors' (A) Disclosure Statement (B) Solicitation of Votes and Voting Procedures and (C) Form of Ballots, and (II) Confirming Amended Joint Prepackaged Chapter 11 Plan of Reorganization of Southeastern Grocers, LLC and Its Affiliated Debtors (Other Than Winn-Dixie Warehouse Leasing, LLC) at 80, *In re Se. Grocers, LLC*, No. 18-10700 (MFW) (Bankr. D. Del. May 14, 2018), ECF No. 487 [hereinafter *Southeastern Confirmation Order*].

161. 486 B.R. 286 (Bankr. D. Del. 2013).

162. *Id.* at 303–04. Judge Shannon's approach to third-party releases is different from Judge Wiles's approach, as Judge Shannon appears more relaxed regarding what counts as consent for approval of the releases. *See supra* notes 143–51 and accompanying text; *see also infra* Part II.A.3.

163. *In re Indianapolis Downs*, 486 B.R. at 304–05.

164. According to Judge Shannon, unimpaired creditors can be deemed to accept the plan and releases, something Judge Wiles explicitly expressed concern over. *See supra* notes 145–49 and accompanying text.

165. *In re Indianapolis Downs*, 486 B.R. at 304–05.

release.<sup>166</sup> The knowing<sup>167</sup> failure to opt out was what made the release consensual.<sup>168</sup>

### 3. How to Treat Unimpaired Creditors

Bankruptcy courts disagree on whether unimpaired creditors, who are presumed to accept a plan, should be deemed to have consented to a release within the plan without a vote on such releases.<sup>169</sup> The Bankruptcy Code sets out the treatment for unimpaired creditors as being presumed to accept the plan without voting.<sup>170</sup> Courts consider unimpaired creditors to have consented to the releases because those creditors will be paid in full and will receive consideration for the releases.<sup>171</sup> However, there appears to be disagreement regarding whether or not the existence of the release creates an impairment to an otherwise unimpaired creditor where they should no longer be presumed to accept the plan.<sup>172</sup>

Judge Wiles found the idea of restricting the rights of nondebtor parties via a third-party release without consent to be troubling.<sup>173</sup> He required unimpaired creditors, who by definition are said to approve the plan, to opt in to the releases, and he is critical of the use of deemed consent.<sup>174</sup>

If a creditor must release a claim against a third party under a plan (as a condition to whatever payment or other treatment the plan provides for the creditor's claim against the debtor), it is difficult to understand how such a

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166. *See id.* at 305.

167. Judge Shannon did not establish the level of knowledge required to be bound. Additionally, Judge Shannon did not discuss whether there is a due process issue if the creditors affected by the releases do not “know” that they will lose a right.

168. Ward & Vine, *supra* note 83. Judge Shannon's view conflicts with Judge Walrath's *Washington Mutual* decision, in which she held that the failure to return the ballot was not consensual. *See supra* notes 157–58 and accompanying text.

169. Compare *In re Indianapolis Downs*, 486 B.R. 286 (holding that failure to opt out regardless of impairment or deemed acceptance status results in being bound), with *Southeastern Confirmation Order*, *supra* note 160 (holding that all creditors, including those unimpaired and deemed to accept, must consent to the release to be bound).

170. *See* 11 U.S.C. § 1126(f) (2012) (“[A] class that is not impaired under a plan, and each holder of a claim or interest of such class, are conclusively presumed to have accepted the plan, and solicitation of acceptances with respect to such class from the holders of claims or interests of such class is not required.”).

171. *See, e.g.*, U.S. Bank Nat'l Ass'n v. Wilmington Tr. Co. (*In re Spansion, Inc.*), 426 B.R. 114, 144 (Bankr. D. Del. 2010) (“[N]o creditor or interest holder whose rights are affected by the ‘deemed’ acceptance language has objected to the Plan . . . . [T]he silence of the unimpaired classes on this issue is persuasive . . . . The unimpaired classes are being paid in full and have received adequate consideration for the release.”).

172. *See In re Chassix Holdings, Inc.*, 533 B.R. 64, 81 (Bankr. S.D.N.Y. 2015).

173. Ryan Boysen, *Westinghouse Secures Approval of Ch. 11 Plan*, LAW360 (Mar. 27, 2018, 6:14 PM), <https://www.law360.com/articles/1026925/westinghouse-secures-approval-of-ch-11-plan> [<https://perma.cc/LM8J-JS52>]; *see also infra* note 201 and accompanying text. *See generally* Transcript of Confirmation Hearing, *In re Westinghouse Elec. Co. LLC*, No. 17-10751 (MEW) (Bankr. S.D.N.Y. Mar. 27, 2018) [hereinafter *Westinghouse Transcript*].

174. Boysen, *supra* note 173; *see also In re Chassix Holdings*, 533 B.R. at 81.



creditor could properly be considered to be “unimpaired” by the Plan in the first place.<sup>175</sup>

He stated that “[t]here are circumstances in which public policy justifies a rule under which people are bound by a proposed action unless they take affirmative steps to note their disagreement.”<sup>176</sup> He explained that third-party releases are different from those circumstances.<sup>177</sup> There is no “general ‘public policy’ in favor of making third-party releases applicable to as many creditors as possible.”<sup>178</sup> Additionally, there is no rule that mentions an opt-out mechanism or a deemed consent mechanism concerning third-party releases.<sup>179</sup>

In *In re Southeastern Grocers, LLC*, Judge Walrath—the judge who decided the *Washington Mutual* case—held that unimpaired creditors should not be deemed to have voted in favor of a release.<sup>180</sup> This is perhaps because the statute deems unimpaired creditors to have accepted the plan<sup>181</sup> but the statute does not mention third-party releases—let alone whether unimpaired creditors should be considered to approve them without further vote. Judge Walrath held that all creditors, even those unimpaired, should be required to affirmatively consent to a release for the release to be deemed consensual; however, if the opt-out provision is present, consent is found in the failure to opt out if creditors are given the opportunity to vote.<sup>182</sup>

In *In re Millennium Lab Holdings II, LLC*, Judge Silverstein found it permissible to impose third-party releases on parties unable to vote and whose rights were allegedly unaffected by the plan,<sup>183</sup> also known as unimpaired creditors.<sup>184</sup> Section 1124(1) of the Bankruptcy Code sets forth the conditions under which a class of claims is impaired.<sup>185</sup> According to Judge Silverstein, this section applies impairment only to claims against the debtor and not to claims against third parties that may be liable to the unimpaired creditors.<sup>186</sup> Therefore, creditors deemed unimpaired against the

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175. *In re Chassis Holdings*, 533 B.R. at 81.

176. *Id.* at 78.

177. *Id.*

178. *Id.*

179. *Id.*

180. See Southeastern Confirmation Order, *supra* note 160, at 80 (“[H]olders of Unimpaired Claims or Interests shall not be deemed to have released the Debtors.”). Holders of unimpaired claims could opt out of the releases by filing an objection instead of the traditional opt out. *Id.* at 10, 58–59.

181. See *supra* notes 26, 170 and accompanying text.

182. See generally Southeastern Confirmation Order, *supra* note 160 (noting that an opt-out provision must be present to find consent in the lack of response). The creditors who objected to the releases were carved out and deemed not to be bound. *Id.* at 59.

183. Richard Epling, *Uses and Possible Misuses of 3rd-Party Releases in Ch. 11*, LAW360 (Sept. 7, 2017, 4:14 PM), <https://www.law360.com/articles/961748/uses-and-possible-misuses-of-3rd-party-releases-in-ch-11> [<https://perma.cc/JE87-SRLK>].

184. 575 B.R. 252, 262–64 (Bankr. D. Del. 2017), *aff’d sub nom.* Opt-Out Lenders v. Millennium Lab Holdings II, LLC (*In re Millennium Lab Holdings II, LLC*), 591 B.R. 559 (D. Del. 2018).

185. 11 U.S.C. § 1124(1) (2012).

186. Epling, *supra* note 183. Section 1124(1) does not define what constitutes impairment of a creditor’s claim, but it states that a creditor is impaired unless the plan leaves unaltered

debtor may be deemed to accept the plan and the plan's third-party releases without express approval because the third-party release does not itself cause impairment.<sup>187</sup>

In *In re Genco Shipping & Trading Ltd.*,<sup>188</sup> the U.S. trustee objected to third-party releases because the claimholders did not affirmatively consent to those releases.<sup>189</sup> The trustee also argued that a release granted solely because a party was deemed unimpaired under a plan would violate § 1124(1) of the Code in that requiring an unimpaired holder of a claim or interest to grant a release would effectively mean that the holder would relinquish legal rights and, thus, would be impaired.<sup>190</sup> Although the court agreed that the classification of a claim or interest as unimpaired should not be equated with the granting of a release,<sup>191</sup> Judge Sean H. Lane of the Southern District of New York nevertheless found that a plan can require the holders of unimpaired claims or equity interests to grant a release to nondebtors even when such parties were not entitled to vote on the plan and did not otherwise consent to, or have an opportunity to opt out of, granting such a release.<sup>192</sup> Therefore, the third-party releases in *Genco Shipping* were permissible if the “*Metromedia* factors” were satisfied.<sup>193</sup>

Judge Shannon in *Indianapolis Downs* found that failure to opt out results in a binding third-party release, regardless of impairment or deemed acceptance of the plan status.<sup>194</sup>

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the contractual rights to claims held by the creditor. Additionally, it does not explicitly limit impairment to claims against only the debtor. *See id.*; *see also In re Millennium Lab Holdings II*, 575 B.R. at 262–64; Transcript of Hearing at 26–57, *In re Millennium Lab Holdings II*, 575 B.R. 252 (Bankr. D. Del. 2017) (No. 15–12284 (LSS)), ECF No. 206 [hereinafter *Millennium Transcript*].

187. Judge Silverstein stated in her 2015 oral bench ruling that the nonvoting creditors consented because (1) the notice of nonvoting status was served on all known nonvoting class members and (2) the releases were in bold and full text, so the nonvoting creditors, including the unsecured creditors, were on notice of the releases and did not object. *See Millennium Transcript*, *supra* note 186, at 27–28; Quirk & Grasso, *supra* note 52. Regarding her 2015 ruling, Judge Silverstein stated, “this ruling is not to be cited back to me.” *See Millennium Transcript*, *supra* note 186, at 5; Quirk & Grasso, *supra* note 52.

188. 513 B.R. 233 (Bankr. S.D.N.Y. 2014).

189. *Id.* at 269.

190. Frank Grese, *Release Me! Release Me!: S.D.N.Y. Bankruptcy Court Upholds Certain Non-Consensual Non-Debtor Releases Granted by Unimpaired Creditors and Equity Holders*, WEIL BANKR. BLOG (July 22, 2014), <https://business-finance-restructuring.weil.com/releases-exculpations/release-me-release-me-s-d-n-y-bankruptcy-court-upholds-certain-non-consensual-non-debtor-releases-granted-by-unimpaired-creditors-and-equity-holders/> [<https://perma.cc/6XX9-HWGN>].

191. *In re Genco Shipping & Trading*, 513 B.R. at 270.

192. *See id.* at 272.

193. *See id.* at 271.

194. *In re Indianapolis Downs, LLC*, 486 B.R. 286, 304–05 (Bankr. D. Del. 2013). According to Judge Shannon, unimpaired creditors can be deemed to accept the plan and the releases, something Judge Wiles explicitly expressed concern over. *See supra* notes 173–75 and accompanying text.

### B. Can You Be Bound Through Silence?

There are differing opinions surrounding a court's ability to enforce a binding third-party release premised on the silence of creditors who neither expressly supported nor opposed the presence of a release. Silence and its potential to be considered deemed or implied consent have different implications according to different judges both within and across districts.

#### 1. Silence Is Not Binding

*Chassix* cited *Washington Mutual* for the holding that “‘inaction’ was not a sufficient manifestation of consent to support a release.”<sup>195</sup> *Chassix* is rooted in agreement with *Washington Mutual* while seemingly disagreeing with the view of inaction espoused in *Indianapolis Downs*, stating: “[c]harging all inactive creditors with full knowledge of the scope and implications of the proposed third party releases, and implying a ‘consent’ to the third party releases based on the creditors’ inaction, is simply not realistic or fair, and would stretch the meaning of ‘consent’ beyond the breaking point.”<sup>196</sup>

*In re Westinghouse Electric Co.*<sup>197</sup> reaffirmed *Chassix* and went further in its discussion of silence and inaction.<sup>198</sup> The *Westinghouse* ballot<sup>199</sup> contained an opt-in provision, which could be checked off indicating plan approval and release approval.<sup>200</sup> On the deemed consent issue, Judge Wiles stated:

the notion that you’re taking away somebody else’s property without additional compensation for it, without identification to what the claims . . . are, without an explanation of why those specific claims can fairly be extinguished, without a proper assessment as to what the actual value of those claims might be, that’s extremely troubling to me.<sup>201</sup>

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195. *In re Chassix Holdings, Inc.*, 533 B.R. 64, 81 (Bankr. S.D.N.Y. 2015) (citing *In re Wash. Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011)).

196. *Id.*

197. No. 17-10751 (MEW) (Bankr. S.D.N.Y. filed Mar. 29, 2017).

198. See *Westinghouse* Transcript, *supra* note 173, at 29–30 (viewing *Westinghouse* in light of the *Chassix* holding).

199. The ballot in *Westinghouse* stated:

IF YOU VOTE TO ACCEPT THE PLAN, YOU WILL BE DEEMED TO HAVE GRANTED THE RELEASES CONTAINED IN . . . THE PLAN, AS SET FORTH ABOVE. IF YOU VOTE TO REJECT THE PLAN AND YOU WISH TO RELEASE CLAIMS YOU MAY HAVE AGAINST THE RELEASED PARTIES AS SET FORTH ABOVE, YOU MAY CHECK THE BOX BELOW TO OPT INTO THE RELEASES; HOWEVER YOU ARE NOT REQUIRED TO DO SO.

Order Approving (A) Proposed Disclosure Statement, (B) Solicitation and Voting Procedures, (C) Notice and Objection Procedures for Confirmation of Debtors’ Plan and Other Relief, (D) Procedures for Assumption and Assignment of Contracts, and (E) The Form of 363 Sale Notice as Alternative Relief at 33, *In re Westinghouse Elec. Co.*, No. 17-10751 (MEW) (Bankr. S.D.N.Y. Feb. 22, 2018), ECF No. 2632.

200. *Id.*

201. *Westinghouse* Transcript, *supra* note 173, at 39.

Judge Wiles, while not explicitly raising due process concerns, stated that the releases should not apply to those who did not actually consent explicitly and required the scope of the releases to be clarified and limited.<sup>202</sup> His statement appears to allude to the potential due process problems that follow from taking away a potential property right through silence.

In *SunEdison*, Judge Bernstein raised concerns as to whether broad third-party releases could and should be allowed to bind nonvoting creditors who were entitled to vote.<sup>203</sup> Judge Bernstein found that the debtors failed to show that nonvoting creditors had consented, either expressly or impliedly, to the releases and the debtors failed to show that said releases were appropriate under the *Metromedia* factors.<sup>204</sup> The court held that the failure to return a plan ballot—that is, silence—would not constitute consent.<sup>205</sup>

The “conspicuous” warnings, stemming from Rule 3016, in the *SunEdison* disclosure statements and ballots regarding the releases did not overcome the court’s threshold for consent, as these warnings were not deemed sufficient or specific enough to allow for consent through silence.<sup>206</sup>

Judge Bernstein viewed implied consent as a contractual issue.<sup>207</sup> Referring to general principles of New York contract law, he found that generally, “[a]bsent a duty to speak, silence does not constitute consent.”<sup>208</sup> The court agreed that there exists three exceptions to the general rule that silence should not be viewed as consent under New York law: (1) when it is supported by the parties’ ongoing course of conduct; (2) when the offeree accepts the benefits of the offer despite a reasonable opportunity to reject them and understands that the offeror expects compensation; and (3) when the offeror has given the offeree reason to understand that that silence will constitute acceptance and the offeree in remaining silent intends to accept the

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202. *In re Chassix Holdings, Inc.*, 533 B.R. 64, 77 (Bankr. S.D.N.Y. 2015). Judge Wiles discusses due process in his 2019 bench decision denying the use of nonconsensual third-party releases in a proposed plan. *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 724–25 (Bankr. S.D.N.Y. 2019).

203. *In re SunEdison, Inc.*, 576 B.R. 453, 455 (Bankr. S.D.N.Y. 2017).

204. *Id.*

205. Judge Bernstein cited *Chassix* and *Washington Mutual* to support the notion that inaction cannot constitute consent. *Id.* at 460 (first citing *In re Chassix Holdings*, 533 B.R. at 81; then citing *In re Wash. Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011)); see Matthew A. Feldman, Christopher S. Koenig & Jason D. St. John, *New York Bankruptcy Court Issues Opinion Denying Proposed Third-Party Releases in SunEdison*, 14 PRATT’S J. BANKR. L. 76, 77–78 (2018).

206. See *In re SunEdison*, 576 B.R. at 460–61; see also Matthew Kelsey et al., *The Battle over 3rd-Party Releases Continues*, LAW360 (Nov. 17, 2017, 4:40 PM), <https://www.law360.com/articles/986673/the-battle-over-3rd-party-releases-continues> [<https://perma.cc/E7E4-5V9T>].

207. *In re SunEdison*, 576 B.R. at 458.

208. *Id.* (“An offeror has no power to transform an offeree’s silence into acceptance when the offeree does not intend to accept the offer.” (quoting *Karlin v. Avis*, 457 F.2d 57, 62 (2d Cir. 1972))); see also James A. Wright III et al., *Silence Is Not Consent: SunEdison Court Rejects Third Party Releases by Passive Consent*, K&L GATES (Nov. 30, 2017), <http://www.klgates.com/silence-is-not-consent-sunedison-court-rejects-third-party-releases-by-passive-consent-11-30-2017/> [<https://perma.cc/AZ5V-M56G>].

offer.<sup>209</sup> Nonetheless, these exceptions are narrow: “As explained by the New York Court of Appeals: ‘Silence operates as an assent, and creates an estoppel, only when it has the effect to mislead.’”<sup>210</sup> In the end, the court found the releases in *SunEdison* too broad and the related ballots unclear regarding opting out.<sup>211</sup> *In re Breitburn Energy Partners LP*<sup>212</sup> reaffirmed *SunEdison*’s take on third-party releases. The *Breitburn* ballot release opt-out provision was far clearer than the *SunEdison* ballot on its effect and due to the fact that the opt-out provision was present, the ballot was approved to be sent out to creditors.<sup>213</sup>

Judge Walrath in *Washington Mutual* held that failing to return a ballot is not “sufficient manifestation” of consent to a third-party release<sup>214</sup> and concluded that “any third party release is effective only with respect to those who affirmatively consented to it by voting in favor of the Plan and not opting out of the third-party releases.”<sup>215</sup> However, Judge Walrath found that if creditors received the opportunity to opt out of the release, the presence of the opt-out provision would be sufficient to deem the releases consensual for the parties who failed to return a ballot.<sup>216</sup>

## 2. Silence Is Binding

Judge Shelly C. Chapman of the Southern District of New York disagreed with Judge Wiles’s view in *Chassix*, which stated that requiring creditors who have rejected or are deemed to have rejected a plan to opt out of a third-

209. *In re SunEdison*, 576 B.R. at 459 (citing RESTATEMENT (SECOND) OF CONTRACTS § 69(1) (AM. LAW INST. 1981)).

210. *Id.* (quoting *Tanenbaum Textile Co. v. Schlanger*, 40 N.E.2d 225, 227 (N.Y. 1942)). Judge Bernstein cited both Delaware and New York case law in support of and opposition to deemed consent through silence. *Id.* at 459–61. He ultimately concluded that the creditors’ silence was not proven to be misleading and could not be considered consent to the release. *Id.* He also stated that the debtors failed to identify the source of the duty to speak pertaining to the silent creditors. *Id.* at 460; McLendon & Picón, *supra* note 45.

211. Alex Wolf, *SunEdison Judge Limits Reach of 3rd-Party Releases*, LAW360 (Nov. 8, 2017, 9:44 PM), <https://www.law360.com/articles/983332/sunedison-judge-limits-reach-of-3rd-party-releases> [https://perma.cc/Z57E-94J5].

212. No. 16-11390 (SMB) (Bankr. S.D.N.Y. filed May 15, 2016).

213. *See* Order (I) Approving Notice of Disclosure Statement Hearing; (II) Approving Disclosure Statement; (III) Establishing a Record Date; (IV) Establishing Notice and Objection Procedures for Confirmation of the Plan; (V) Approving Solicitation Packages and Procedures for Distribution Thereof; (VI) Approving the Forms of Ballots and Establishing Procedures for Voting on the Plan; (VII) Approving the Form of Notice to Non-Voting Classes Under the Plan; and (VIII) Approving the Rights Offering Procedures and Related Matters, *In re Breitburn Energy Partners LP*, No. 16-11390 (SMB) (Bankr. S.D.N.Y. Dec. 1, 2017), ECF No. 1885 [hereinafter *Breitburn Ballot*]. The ballot stated that “[i]f you vote to accept or reject the Plan and submit a ballot without checking the box . . . you will be deemed to consent to the releases set forth in . . . the Plan. If you fail to vote, you will not be bound by the releases.” *Id.* Exhibit A, at 18.

214. *In re Wash. Mut., Inc.*, 442 B.R. 314, 355 (Bankr. D. Del. 2011) (citing *In re Zenith Elecs. Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999)).

215. *Id.*

216. *See id.* at 353. Additionally, it is important for those rejecting the plan to opt out of the releases because they could still be bound by the releases if the plan is approved. *Id.*

party release sets up a trap.<sup>217</sup> In *In re Cumulus Media Inc.*,<sup>218</sup> the court reasoned: “Inaction is action under appropriate circumstances. When someone is clearly and squarely told if you fail to act your rights will be affected. That person is then given information that puts them on notice that they need to do something or else. That’s not a trap.”<sup>219</sup> Judge Chapman highlighted that the purpose of Chapter 11 reorganizations should be to give a fresh start to the debtor.<sup>220</sup> Judge Chapman’s view supports consensual third-party releases provided that notice is clear, the effect of inaction is on the first page, and the disclosure and ballot clearly direct the recipient to the ballot’s opt-out section.<sup>221</sup> She found that silence in this case constituted consent and that the standards for nonconsensual releases had been satisfied.<sup>222</sup>

The third-party releases in *Indianapolis Downs* were, according to Judge Shannon, enforceable against the silent parties who abstained from voting and did not otherwise return a ballot with the opt-out box checked.<sup>223</sup> Because they had the ability to opt out and decided for whatever reason not to,<sup>224</sup> the court considered the parties to have consented to the releases given that they had the opportunity to affirmatively reject them.<sup>225</sup>

In February 2018, in *In re TK Holdings, Inc.*,<sup>226</sup> Judge Shannon again found that creditors who failed to return the ballots were bound to the releases, as they were deemed to have consented given that the releases included a provision binding parties who abstained from voting even though they had the opportunity to opt out.<sup>227</sup> Under the ballot approved by Judge

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217. Cumulus Transcript, *supra* note 115, at 27–28; *see also In re Chassix Holdings, Inc.*, 533 B.R. 64, 79 (Bankr. S.D.N.Y. 2015); McLendon & Picón, *supra* note 45.

218. No. 17-13381 (SCC) (Bankr. S.D.N.Y. filed Nov. 29, 2017).

219. Cumulus Transcript, *supra* note 115, at 27–28; *see also* McLendon & Picón, *supra* note 45.

220. Cumulus Transcript, *supra* note 115, at 28; McLendon & Picón, *supra* note 45.

221. McLendon & Picón, *supra* note 45 (citing Cumulus Transcript, *supra* note 115, at 27–28, 30, 36).

222. *See id.*

223. *In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013).

224. “[T]he record reflects these parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots.” *Id.*

225. *Id.* at 305. The U.S. trustee filed an objection to enforceability of the releases against the silent creditors absent affirmative consent. *Id.* at 304. Judge Shannon stated that “case law teaches that no such hard and fast rule applies . . . [The *Spansion* court] noted that no creditor or interest holder whose rights were affected by the ‘deemed’ acceptance language objected to the plan, and that ‘the silence of the unimpaired classes on this issue is persuasive.’” *Id.* at 305 (quoting U.S. Bank Nat’l Ass’n v. Wilmington Tr. Co. (*In re Spansion, Inc.*), 426 B.R. 114, 144 (Bankr. D. Del. 2010)).

226. No. 17-11375 (BLS) (Bankr. D. Del. filed June 25, 2017).

227. Order Pursuant to 11 U.S.C. §§ 105, 502, 1125, 1126, and 1128, Fed. R. Bankr. P. 2002, 3003, 3016, 3017, 3018, 3020, and 9006, and Local Rules 2002-1, 3017-1, and 9006-1 for Entry of an Order (I) Approving the Proposed Disclosure Statement and the Form and Manner of the Notice of a Hearing Thereon, (II) Establishing Solicitation and Voting Procedures, and (III) Establishing Notice and Objection Procedures for Confirmation of the Debtors’ Plan, *In re TK Holdings, Inc.*, No. 17-11375 (Bankr. D. Del. Jan. 5, 2018), ECF No. 1639 [hereinafter TK Order]. The ballot for voting creditors stated:

Shannon, parties who were deemed to have rejected the *TK Holdings* plan were able to opt out of the release only by filling out the opt-out provision.<sup>228</sup> There, silence was deemed consent because there was a warning that such silence would bind the parties to the releases and the creditor could be assumed to have read the plan's terms.<sup>229</sup>

Once again, in May 2018, Judge Shannon confirmed the use of third-party releases in *In re Remington Outdoor Co.*<sup>230</sup> with the same opt-out mechanism found in *Indianapolis Downs*.<sup>231</sup> The U.S. trustee objected to the release and argued that silence should not be viewed as assent.<sup>232</sup> Judge Shannon responded to the U.S. trustee's objection by stating that, while he was open to revisiting *Indianapolis Downs* and the opt-out mechanism, *Remington* did not present the appropriate circumstances.<sup>233</sup> He did require that "employees and former employees of the debtor and the former employees and current employees of the releasing parties . . . be stricken from" the list of releasing parties as those employees should not be expected to be on notice that they were given such releases and including "employees" in the release could inadvertently lead to the unintentional release of employees' claims.<sup>234</sup> Judge Shannon's removal of employees appears to make an effort to narrow an otherwise sweeping release.

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YOU MAY CHECK THE BOX BELOW TO OPT OUT OF THE RELEASE **ONLY IF** YOU VOTE TO **REJECT** THE PLAN. IF YOU (I) VOTE TO ACCEPT THE PLAN, (II) DO NOT SUBMIT A BALLOT TO ACCEPT OR REJECT THE PLAN, OR (III) REJECT THE PLAN BUT DO NOT OPT OUT OF THE RELEASE PROVISIONS OF THE PLAN, YOU WILL BE DEEMED TO HAVE GRANTED THE RELEASES.

*Id.* Exhibit 3, at 16.

228. *Id.* Exhibit 4-2, at 3 ("[W]hile you are not entitled to vote to accept or reject the Plan, the opt out election . . . provides you with the separate option to not grant the voluntary release of the Released Parties . . .").

229. *Id.*

230. No. 18-10684 (BLS) (Bankr. D. Del. filed Mar. 25, 2018).

231. Transcript of Hearing at 103, *In re Remington Outdoor Co.*, No. 18-10684 (BLS) (Bankr. D. Del. May 2, 2018) [hereinafter *Remington Transcript*]. The transcript makes clear that the releases involved are third-party releases. *See id.* at 52–53 ("[W]e're talking about the third-party releases, not the debtor releases.").

232. The Securities and Exchange Commission (SEC) also objected to the plan due to silence being considered consent under the plan. *Id.* at 43. The SEC went on to say that "parties should be able to consent to the releases separately and apart from voting to accept the plan." *Id.*

233. *Id.* at 72–73. The *Remington* ballot addressed the repercussions of a silent response to the ballot by stating: "If the Plan is confirmed by the Bankruptcy Court, it will be made binding upon you regardless of whether or not you vote and regardless of whether or not [the class] accepts the Plan." Debtors' Motion for Entry of (I) Order (A) Scheduling Combined Hearing on Adequacy of Disclosure Statement and Confirmation of Plan, (B) Approving Form and Manner of Notice of Combined Hearing and Commencement of Chapter 11 Cases, (C) Approving Solicitation of Non-Accredited Holders, (D) Establishing Procedures for Objecting to Disclosure Statement or Plan, (E) Conditionally Waiving Requirement to File Statements and Schedules, and (F) Directing That a Meeting of Creditors Not Be Convened, and (II) Order (A) Approving Prepetition Solicitation Procedures, (B) Approving Adequacy of Disclosure Statement, and (C) Confirming Plan, Exhibit D at 3, *In re Remington Outdoor Co.*, No. 18-10684 (Mar. 25, 2018), ECF No. 12-4 [hereinafter *Remington Ballot*].

234. *Remington Transcript*, *supra* note 231, at 69.

Without addressing the due process concerns associated with silent creditors, the court reaffirmed its approval of the opt-out provision<sup>235</sup> and construed silence as acceptance, so long as the parties that were not employees received the ballot and did not specifically opt out.<sup>236</sup>

### III. HOW DO WE PROTECT CREDITORS' RIGHTS?

The Constitution clearly requires due process.<sup>237</sup> Due process, however, is not frequently examined, questioned, or evaluated in Chapter 11 plan approvals containing third-party releases. To protect creditors' due process rights, it is important for courts and practitioners to recognize the connection between due process and consent to relinquish a claim against a nondebtor third-party during plan confirmations. Both contract law and due process rights are embedded in the debate of what constitutes consent to a third-party release and whether consent can be deemed through silence.<sup>238</sup> If the creditors do not bring up the due process issue found within a consent determination in a motion on their own, courts should do so *sua sponte*, as the issue is one of great importance.<sup>239</sup>

#### A. Permissibility: Which Consent Approach?

The Seventh Circuit's approach to the permissibility<sup>240</sup> of third-party releases regardless of a consent determination carries a potential problem as it appears to have no limit as to what the bankruptcy courts could ultimately implement in pursuit of a plan's confirmation.<sup>241</sup> Sections 105 and 1123 have the potential to act as blank checks for the bankruptcy courts to do

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235. The opt-out provision stated (in bold type):

IF YOU VOTED TO REJECT THE PLAN OR ABSTAINED FROM VOTING AND YOU DO NOT OPT OUT OF THE THIRD-PARTY RELEASES BY CHECKING THE BOX BELOW, YOU WILL BE DEEMED TO HAVE UNCONDITIONALLY, IRREVOCABLY AND FOREVER RELEASED AND DISCHARGED THE RELEASED PARTIES (AS DEFINED IN THE PLAN) FROM, INTER ALIA, ANY AND ALL CAUSES OF ACTION (AS DEFINED IN THE PLAN) EXCEPT AS OTHERWISE SPECIFICALLY PROVIDED IN THE PLAN.

Remington Ballot, *supra* note 233, at 9.

236. Remington Transcript, *supra* note 231, at 72–73 (confirming the plan as consistent with *Indianapolis Downs*); *see supra* Part II.A (explaining Judge Shannon's views on affirmative consent and affirmative rejection in both *Indianapolis Downs* and *Remington*). In *Remington*, if creditors voted to accept the plan, they were similarly deemed to have accepted the third-party release. Remington Transcript, *supra* note 231, at 69–73.

237. *See supra* Parts I.F–G, II.

238. *See supra* Part I.F.

239. *See supra* Part I.G. Judge Bernstein raised *sua sponte* whether a nonvoting creditor consented to a release. *In re SunEdison, Inc.*, 576 B.R. 453, 455 (Bankr. S.D.N.Y. 2017). Judge Wiles in *In re Aegean Marine Petroleum Network, Inc.*, 599 B.R. 717, 725 (Bankr. S.D.N.Y. 2019) stated, “we should not lose sight of the fact that when we impose involuntary releases we do not provide claimants with other procedural and substantive rights that they ordinarily would have.”

240. *See supra* Part I.C.

241. *See supra* notes 68–69 and accompanying text.



whatever they deem necessary to confirm a plan.<sup>242</sup> The majority view,<sup>243</sup> however, allows third-party releases in limited circumstances, and each circuit applies a different multifactor analysis.<sup>244</sup> The majority view provides creditors with some due process protection, depending on the determination of consent, and enables the confirmation of plans that are tied to third parties receiving a release. The various factors and standards applied in majority-view circuits to determine the permissibility of third-party releases do not necessarily need to be changed. However, a single set of factors would promote greater consistency across bankruptcy courts.

### *B. Defining Consent While Considering Due Process*

A definition of consent in the context of third-party releases would protect creditors bound by those releases. Due process violations could be avoided if consent was obtained on an individual level; this avoids the removal of an individual's claim or right simply because a majority voted to do so. One creditor's choice to waive their rights should not have any effect on another creditor's rights. Because a plan is confirmed upon approval by every class of creditor and the court, a plan will not necessarily be stopped because one creditor does not want to release the nondebtor third party. This Note considers a requirement that creditors affirmatively consent to third-party releases to be the best method to avoid due process violations. This would allow a court to approve the plan containing a third-party release even if individual creditors opt in or out of the release. Creditors that reject the plan should not be bound by a third-party release unless they opt in to said release.<sup>245</sup>

Allowing creditors who either abstain from voting or reject a plan but fail to opt out to be bound by a release ignores the contract principle that a person cannot be deemed to accept or be bound through silence or inaction.<sup>246</sup> Reducing or removing the ability for courts to approve third-party releases through consent-by-silence will protect those silent creditors' due process rights. Because silence can be viewed to have various meanings, courts should not assume that silence means consent and releases should not apply to silent parties.<sup>247</sup> Silent ballots should not extinguish claims held by creditors by default because these deemed-consent ballots violate due process. Allowing silent-ballot creditors to maintain their claims does not mean that the creditor will necessarily pursue their claims, but it does protect their due process rights by not releasing their claims without affirmative consent. Using an opt-out provision instead of requiring creditors to file physical objections to the releases in court enables creditors to easily vote

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242. See, e.g., *supra* notes 73–75 and accompanying text.

243. See *supra* Part I.B.

244. See *supra* Part I.D.

245. See *supra* Parts II.A.1, II.A.3, II.B.1.

246. See, e.g., *Karlin v. Avis*, 457 F.2d 57, 62 (2d Cir. 1972); *Albrecht Chem. Co. v. Anderson Trading Corp.*, 84 N.E.2d 625, 626 (N.Y. 1949); see also *supra* Parts I.E, II.

247. See *supra* Part II.B.1.

when they otherwise might refrain due to the costs and effort of hiring an attorney.<sup>248</sup>

*C. Increasing Clarity of Third-Party Releases for the Benefit of Creditors*

Aligning with the ABI's recommendation, this Note recommends that third-party releases should be "clearly and conspicuously highlighted and explained in the plan and the disclosure statement."<sup>249</sup> Ballots currently contain pages of bold and all-caps text<sup>250</sup> that may lead a creditor to misunderstand the meaning of the third-party release. To better comply with the "conspicuous" requirements of Rule 3016(c), ballots should be clearer as to the who, what, and how of these releases—even at the expense of slowing down plan confirmations.<sup>251</sup> Judge Shannon's philosophy that a creditor is bound to a release when they have not specifically opted out carries the worrisome possibility that a creditor who does not understand the release will lose their right to have their claims heard, which potentially creates due process violations.<sup>252</sup>

Plan ballots should explicitly identify the scope of the release, the parties covered, and the consequences of opting in or out of the release to avoid improperly eliminating creditors' rights and claims against third parties.<sup>253</sup> This is particularly important in plans containing blanket releases—where the claims being released may be unknown<sup>254</sup>—because of the breadth of possibilities and risks to due process. Broad releases should not be approved freely. Courts should require the "broader" releases, if necessary for the plan, to include topics or headings that narrow down the provided or asked-for releases to avoid due process violations and public policy concerns.<sup>255</sup> It seems very difficult to justify a blanket waiver of unknown claims, and courts should attempt to align third-party release doctrine with established contract law.

Releases and disclosure statements should be sent to every individual or creditor who would be bound if the plan were confirmed, regardless of impairment. Individual creditors deemed to reject the plan should also be given the opportunity to opt out of the releases<sup>256</sup> in case the plan is ultimately confirmed, so they do not automatically, and involuntarily, lose their rights to claims. Third-party releases in a plan should be narrowly

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248. See McLendon & Picón, *supra* note 45.

249. AM. BANKR. INST., *supra* note 14, at 252; see *supra* Part I.E.

250. See, e.g., Breitburn Ballot, *supra* note 213, at 18; TK Order, *supra* note 227, Exhibit 3, at 16.

251. See *supra* Part I.E; see also Tina Moss, *No Clear Disclosure?: No 3rd-Party Release in Ch. 11*, LAW360 (Jan. 28, 2013, 2:39 PM), <https://www.law360.com/articles/410254/no-clear-disclosure-no-3rd-party-release-in-ch-11> [<https://perma.cc/ZT9R-PWVZ>].

252. See *supra* notes 161–68, 224–28 and accompanying text; see also *supra* Part I.F.

253. See *supra* Part I.E.

254. AM. BANKR. INST., *supra* note 14, at 253.

255. For an example of a court "narrowing" the language of a third-party release, see *supra* notes 233–34.

256. This idea is aligned with a recommendation by Kathrine McLendon and Lily Picón. See McLendon & Picón, *supra* note 45.

tailored and cover only the most important of the third parties' concerns, so the third parties feel covered enough to fund the reorganization.

An additional statement should be placed on the ballot—away from the general all-bold, all-caps text—that explains what happens if you fail to return the ballot and what opting out means. This will appropriately highlight the dangers of consent through silence and make explicitly sure that creditors know they are waiving a right to a claim, which would potentially reduce due process violations.<sup>257</sup> This additional layer of due process protection may come at the cost of an expeditious plan confirmation.

#### *D. The Future Use of Third-Party Releases*

The use of third-party releases facilitates speedy bankruptcies. It is not advisable to place a blanket prohibition on using third-party releases—especially if affirmative consent is given by the creditors issuing a release—because the releases promote the funding of large corporate restructuring, which is beneficial for society.<sup>258</sup> The “funding facilitation” argument is a powerful one. It is the concept that a third party can condition their monetary contribution along the following lines: “I will contribute as long as I know someone or something will not come out of the woodwork and force me to pay a multiple of what I thought I was paying to settle this once and for all. I want to put a cap on my liability exposure.” Third-party releases should not be eliminated because they are also critical in reaching settlements in complex disputes, and those settlements are prerequisites to any successful confirmation of the plan of reorganization.<sup>259</sup> Users of these third-party releases, however, must acknowledge that there is a due process concern and courts should require additional steps or qualifications to protect creditors' due process rights.

Until the Supreme Court decides the definition of consent in the bankruptcy-release context and addresses the due process concerns surrounding such releases, counsel to debtors should keep the Due Process Clause in mind in preparing these Chapter 11 plans by specifying both the released parties by name or readily identifiable group and the claims or general types of claims to be released, in addition to being prepared to justify releases on a party-by-party and claim-by-claim basis. Lawyers can utilize an opt-in ballot to allow for clarity in voting; however, many practitioners decide to utilize opt-out ballots because opt-in ballots may ultimately lead too many creditors to not be bound by a plan's release, and this could impact reorganization funding conditioned on a certain percentage of creditors accepting a release. Opting in, however, protects creditors' rights and

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257. See *supra* Parts I.E, I.G; see also *supra* notes 150–56.

258. AM. BANKR. INST., *supra* note 14, at 255 (“[A] blanket prohibition on third-party releases was inadvisable. The Commissioners discussed case examples and particular fact patterns in which third-party releases facilitated a confirmable plan and ultimately benefited all stakeholders.”); see also McLendon & Picón, *supra* note 45.

259. AM. BANKR. INST., *supra* note 14, at 255; McLendon & Picón, *supra* note 45.

prevents any misunderstandings surrounding whether the release is voluntary.

#### CONCLUSION

The Supreme Court has yet to issue a decision or statement regarding the overlap of due process and third-party nondebtor releases, whether consensual or nonconsensual. Additionally, the Court has not issued a ruling regarding third-party releases and their use and role in Chapter 11 restructurings. Such a decision would eliminate the ability for a debtor to forum shop in bankruptcy courts in search of a court that looks favorably upon their desired use of third-party releases. The controversy surrounding the various creditor consent definitions in bankruptcy reorganizations carries potential due process violations that, if left unresolved, may perpetuate a violation of creditors' or other individuals' constitutional rights. Currently, executives and officers of businesses who wish to shield and protect themselves and bankruptcy funders from liability will most likely, through an informed counsel's guidance, file for bankruptcy in a jurisdiction that accepts third-party releases with a low threshold for obtaining consent.<sup>260</sup> Courts should be mindful of the potential due process violations associated with deemed or implied consent to third-party claim releases and should protect Fifth and Fourteenth Amendment rights. Courts should require creditors to affirmatively consent by expressly opting in to the release on the plan ballot before approving a plan and release as binding. If courts utilize the opt-out method, those creditors who are silent—or who do not respond to the opt-out portion of the ballot—should not be bound. To protect the rights of releasing creditors, the courts, debtors, and other plan proponents should ensure that the consent of releasing creditors is affirmatively obtained.

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260. See McLendon & Picón, *supra* note 45; Schwartz & Perez, *supra* note 9.