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To Release Or Not to Release – If That Is the Question, What Is the Answer?

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In a recent decision by the Bankruptcy Court for the District of Delaware, the court adopted a flexible approach to consensual third party releases in a plan of reorganization. In *In re Indianapolis Downs, LLC,* 2013 Bankr. LEXIS 384 (Bankr. D. Del. Jan. 31, 2013), the court permitted third party releases where creditors failed to opt out of the release provisions of the plan either by not submitting their vote on the plan, or by voting against the plan but failing to check the "opt out" box on the ballot. The *Indianapolis Downs* decision highlights a split in the Delaware bankruptcy court with the decision handed down in *In re Washington Mutual, Inc.,* 442 B.R. 314 (Bankr. D. Del. 2011).The *Indianapolis Downs* debtors operated a horse racing track and casino in Shelbyville, Indiana. The debtors filed for Chapter 11 protection in April 2011, and within a year had proposed a plan, which included certain third party releases. Third party releases are releases by non-debtors of non-debtors, and are often sought in a plan to enable raising new capital or to avoid litigation that would hamper the reorganized debtor. While some jurisdictions have adopted per se prohibitions against such releases, other jurisdictions will consider these factors in analyzing whether such releases are appropriate: (1) an identity of interest between the debtor and the third party, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete assets of the estate; (2) substantial contribution by the non-debtor of assets to the reorganization; (3) the essential nature of the release to the reorganization to the extent that, without the release, there is little likelihood of success; (4) an agreement by a substantial majority of creditors to support the release, specifically if the impaired class or classes "overwhelmingly" vote to accept the plan; and (5) a provision in the plan for payment of all or substantially all of the claims of the class or classes affected by the release.

The debtors' plan in *Indianapolis Downs* applied certain third party release provisions to claimholders who "(i) affirmatively vote to accept or reject the Plan and do not opt out of granting the releases, (ii) are unimpaired pursuant to the Plan and therefore deemed to accept the Plan pursuant to section 1126(f) of the Bankruptcy Code, or (iii) abstain from voting on the Plan and who do not otherwise submit a Ballot indicating their desire to opt out of the releases." Id. at *41-42.

Judge Shannon cited other jurisdictions for their "flexible approach in evaluating whether a third party release was consensual." *Id.* at *44. Finding that no "hard and fast rule" of affirmative consent to third party releases exists, *id.* at *44, the court held that where claimholders abstained from voting on a plan, or voted to reject the plan but did not otherwise opt out of the third party releases despite having detailed instructions on how to do so, those third party releases were properly characterized as consensual and could therefore be approved.

This approach, which places a burden on claimholders to take action by affirmatively opting out from third party releases, may be seen as contradictory to the approach adopted by Judge Walrath approximately a year earlier, in *In re Washington Mutual, Inc.* In that case, starting from the premise that "[t]his Court has previously held that it does not have the power to grant a third party release of a non-debtor," (*id.* at 352)(citations omitted), the court refused to approve third party releases, where, among other things, such releases would have been deemed accepted by creditors who did not submit a ballot, stating that "[f]ailing to return a ballot is not a sufficient manifestation of consent to a third party release." *Id.* at 355. The court concluded that a third party release is effective only against those who affirmatively consented to it by voting in favor of the plan and not opting out of the releases (the judge did not confirm the plan on other grounds). *Id.*

These two recent yet disparate decisions from the Bankruptcy Court for the District of Delaware represent only the tip of the third-party-release iceberg, and exemplify the wide range of approaches, often at odds with each other even within the same court, to this difficult subject. Parties facing a plan that includes third party release are encouraged to seek assistance from knowledgeable bankruptcy counsel concerning their particular facts and circumstances, including the law in the applicable jurisdiction concerning such releases.

If you have any questions about this decision or its implications, please call your principal Mintz Levin attorney or one of the attorneys noted on this advisory.

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