



“I love it when a plan comes together!”

-John “Hannibal Smith”

**But...are you now heading down the
boulevard of broken dreams?**

Post-Confirmation Issues: Plans and Pitfalls

- Ongoing monitoring
- Flexibility in implementation
- Communication among stakeholders
- Strategies for dealing with disputes while preserving resources



Part I: Ongoing Monitoring of A Confirmed Plan



Ongoing Monitoring:

Overview of Liquidation Trustee/Financial Advisor's Role

1. Cash management
2. Stewardship
3. Administrative responsibilities
4. Claims reconciliation
5. Assist in Enforcement of Agreements
 - a) (Earnout Example)
 - b) (Collections on Receivables)
6. Reporting

Purpose of Reporting

- The information collected by UST Form 11–PCR intended to be used to evaluate whether a chapter 11 debtor is performing as anticipated under a confirmed plan.
 - (1) Whether a debtor is able to substantially consummate a confirmed plan;
 - (2) Whether the debtor is in material default under a confirmed plan; and
 - (3) Whether the debtor is paying fees required under 28 U.S.C. 1930.

If the debtor fails to perform under the confirmed plan, the United States Trustee, creditors, or other parties in interest may bring an appropriate motion to dismiss the case, revoke a confirmed plan, or convert the case to a case under chapter 7. See 11 U.S.C. §§ 1112(b)(4)(K), (M), and (N); 11 U.S.C. § 1144.
- Small business and subchapter V cases are not subject to the “**Final Rule**” and can use Official form 425C.

¹ Periodic Reports in Cases Filed Under Chapter 11 of Title 11, published at 28.C.F.R.SS58.8.

The Final Rule

- Since June 21, 2021, the United States Trustee Program’s “Final Rule¹” became effective. The Final Rule requires that chapter 11 debtors-in-possession and trustees, other than in small business and subchapter V cases, to file monthly post-confirmation reports using streamlined, data-embedded, uniform forms in every judicial district where the U.S. Trustee Program operates.
- Small business and subchapter V cases are not subject to the “**Final Rule**” and can use Official form 425C.

¹ Periodic Reports in Cases Filed Under Chapter 11 of Title 11, published at 28.C.F.R.SS58.8.

Accounting Methodology

- **Generally Accepted Accounting Principles (GAAP)**
- The US Trustee has found that Generally Accepted Accounting Principles (GAAP) may not be the appropriate accounting method for certain debtors as it might be unduly burdensome for those debtors who do not regularly use it.
- Accordingly, debtors who do not already follow GAAP will not be required to adopt GAAP to prepare the periodic reports.
- Debtors are permitted to complete the periodic reports using the accounting method the debtor used prepetition.

Timing

1. Monthly
2. Quarterly
3. Discussion point: what are requirements if conditions change dramatically during an interim period and there is reason to believe the plan is no longer feasible?

Discussion

1. How might accounting conventions (GAAP v Non-GAAP) impact reporting and the interpretation of agreements?
2. How might compliance (or lack of) with reporting requirements impact plan implementation or the ability to obtain a discharge?
3. Managing the “War Chest”:
 - a) Reporting should identify professional fees incurred with respect to certain recoveries, even though they may not have been paid yet.
4. Claims reconciliation:
 - a) There are requirements to disclose planned post-petition objections to claims
 - i. Example- reclassification claims, when class was unimpaired
 - ii. See Local Rules
 - b) Include reservation of rights in plans

Litigation Trust Considerations

1. Financial advisors may maintain custody of the books and records required to pursue litigation, and
2. Perform the financial analysis necessary to support a cause of action
 - a) Examples: the insolvency requirement for certain causes of action
 - b) Ordinary course considerations
3. Evaluate the financial cost benefit of certain causes of action based on the accounting data and potential recovery
 - a) The estate representative must perform a cost-benefit analysis prior to initiating or considering whether to continue litigation as a part of an effort to enhance recoveries
 - b) A significant issue in this analysis when pursuing constructive fraudulent transfer actions under 11 U.S.C. § 548(b) or related state court authority is whether the debtor was “insolvent” on the date of the transfer.
 - i. Unlike with preference actions under 11 U.S.C. § 547, where there is a presumption of insolvency, no such presumption exists under Section 548(b).
 - ii. When pursuing constructive fraudulent transfer actions, the estate representative must carefully consider whether to go to trial on the “insolvency” question as a ruling against the representative on this issue may significantly undermine similar actions against all third parties.

Post-Confirmation Litigation – Adequacy of Disclosure

It is common for litigation to be brought post-confirmation as part of a debtor's reorganization or wind down.

The primary issue is whether a Bankruptcy Court has jurisdiction over a claim that is inadequately disclosed in the disclosure statement and plan.

For example, typically a confirmed plan and disclosure statement will generally describe "Causes of Action" that are retained. However, it may not, for example, specifically identify claims against directors and officers to be pursued post-confirmation.

Some courts hold that such "general language" about post-confirmation litigation does not provide adequate notice to creditors (or to the Court, for that matter).

Post-Confirmation Litigation – Adequacy of Disclosure (cont'd)

Courts reasons that if the litigation is truly critical to the plan's implementation, it would have been more specifically described in the disclosure statement and plan so that creditors could have considered its effect when deciding whether to vote in favor of the plan.

Creditors argue that the pursuit of these non-core claims do not call for the interpretation of a plan provision. Therefore, the courts often find there is no “close nexus” of these non-core claims to the bankruptcy case to support jurisdiction.

A bankruptcy court's post-confirmation jurisdiction is often an uncertain area that practitioners should consider in advance when developing the debtor's plan and disclosure statement.

Claims Reconciliation Disclosure Guidelines

Local Form Combined Plan/DS for Small Business Debtors, requires debtors to “set forth amount and number of Claims in each class that will be objected to.”

There is no evidence of a Court denying a plan because the debtor did not comply with this section, but there is some expectation that the debtor will [at least attempt to] identify objectionable claims at the time of confirmation.



Flexibility In Implementation

Amending a Plan Post-Confirmation – Traditional Chapter 11 vs. Sub V Chapter 11

1. Modification under traditional Chapter 11 is governed by 11 U.S.C. § 1127.
2. In Sub V, pursuant to 11 U.S.C. § 1189, only a debtor can propose a plan and under U.S.C. § 1193 only a debtor can modify a plan.
 - a) Discussion: Can other parties impact amendments depending on Debtors' post-confirmation performance under 11 U.S.C. § 1191?

Amending a Plan Post-Confirmation - 11 U.S.C. § 1127

In a traditional chapter 11, Section 1127 controls and unlike in a Sub V case where Section 1193(c) allows for it, the debtor or plan proponent in a traditional chapter 11 has no ability to modify a plan after it has been “substantially consummated.”

Specifically, Section 1127(b) provides that the proponent of a plan or the reorganized debtor "may modify such plan at any time after confirmation of such plan and before substantial consummation of such plan," again unless the proposed modification violates the Bankruptcy Code's requirements regarding the classification of claims and interests or the contents of a plan. 11 U.S.C. § 1127(b) (emphasis added).

Amending a Plan Post-Confirmation - 11 U.S.C. § 1127 (cont'd)

Moreover, "[c]ourts have routinely rejected attempts by plan proponents to circumvent section 1127(b) and change the plan merely by calling the requests a motion to modify the confirmation order, or a motion for reconsideration or to modify a plan-related document, or any application that nonetheless affects rights under the plan, such as a motion to clarify or a motion to classify claims." Collier at ¶ 1127.03[2][a] (citations omitted).

Amending a Plan Post-Confirmation II U.S.C. § 1127 (cont'd)

Some courts have even ruled that "serial" (successive) chapter 11 filings are not permitted and that a second plan may not modify the first plan in the absence of "unanticipated changed circumstances" that were unknown at the time the prior plan was substantially consummated and substantially affected the debtor's ability to implement the prior plan. *See, e.g., Elmwood Dev. Co. v. General Elec. Pension Trust (In re Elmwood Dev. Co.)*, 964 F.2d 508, 512 (5th Cir. 1992); *Fruehauf Corp. v. Jartran, Inc. (In re Jartran, Inc.)*, 886 F.2d 859, 867 (7th Cir. 1989).

Amending a Plan Post-Confirmation – Individuals

11 U.S.C. § 1127

If the debtor is an **individual**, Section 1127(e) controls and similar to a Sub V case, modification of the plan can occur “whether or not the plan has been substantially consummated” and at “any time after confirmation of the plan but before the completion of payments under the plan[.]”

Amending a Plan Post-Confirmation II U.S.C. § 1127 (cont'd)

Additionally, Section 1141(a) of the Bankruptcy Code provides that the terms of a confirmed chapter 11 plan are binding on all parties. Sections 1127 and 1141, when taken together with other related provisions of the Bankruptcy Code, impose an important element of finality in chapter 11 cases that allows stakeholders to rely on the provisions of a confirmed chapter 11 plan. *See generally Collier on Bankruptcy* (“*Collier*”) ¶ 1127.03[2][a] (16th ed. 2022) (“In enacting section 1127(b), Congress intended to ‘safeguard the finality of plan confirmation.’”).

Amending a Plan Post-Confirmation II U.S.C. § 1127 (cont'd)

Absent modification of a chapter 11 plan or an order revoking confirmation (see 11 U.S.C. § 1144, which authorizes the court to revoke a confirmation order "only if such order was procured by fraud" within 180 days of confirmation), appeal of an order confirming a chapter 11 plan is the only recourse. However, such an appeal may be deemed moot absent a stay pending appeal if the plan has been substantially consummated before the appeal can be heard. See *generally Collier* at ¶ 1129.09 (discussing the doctrine of "equitable mootness").

11 U.S.C. § 1101(2) – Substantial Consummation

Under section 1101(2) of the Bankruptcy Code, "substantial consummation" of a chapter 11 plan occurs when:

- (i) substantially all of the property to be transferred under the plan has been transferred;
- (ii) the debtor or its successor has assumed the business or management of substantially all of the property dealt with by the plan; and
- (iii) distributions under the plan have commenced.

11 U.S.C. § 1101(2) – Substantial Consummation (cont'd)

- *See U.S. Trustee v. The Official Committee of Equity Security Holders (In re: Zenith Electronics Corporation)*, 329 F.3d 338 (3d Cir. 2003)
- Following “substantial consummation” of a chapter 11 plan, can you close a case before all distributions are made or before litigation is resolved – what are advantages and are there any hurdles?

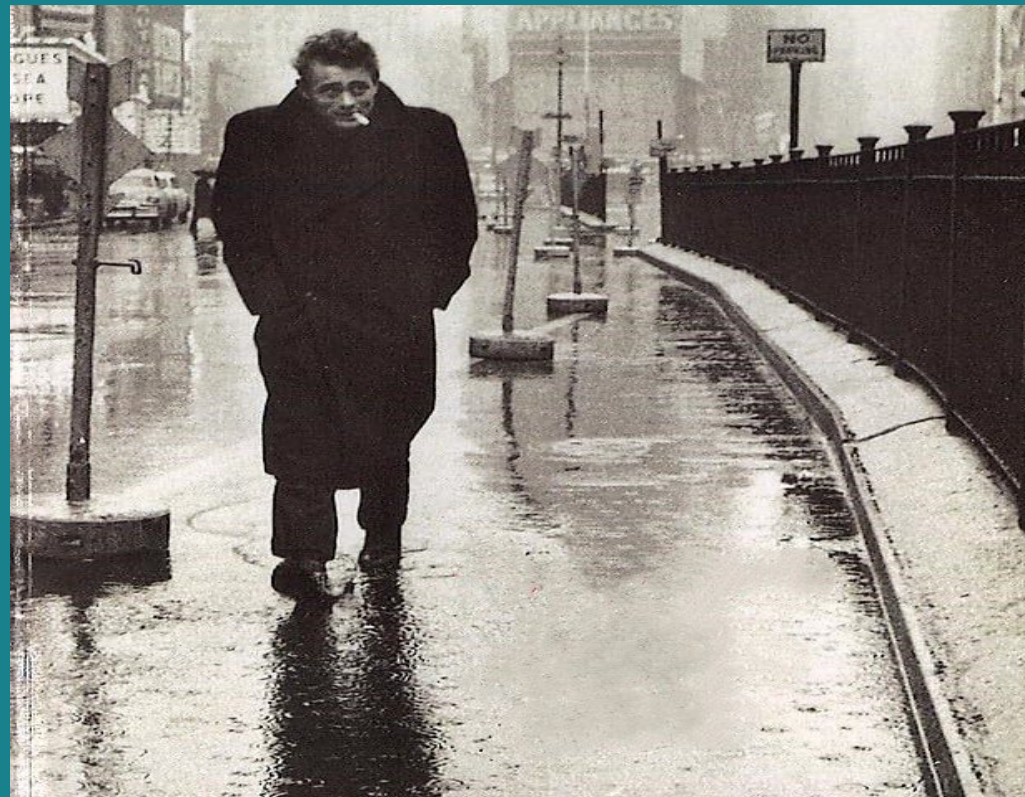
Amending a Plan Post-Confirmation Sub V Chapter 11 – U.S.C. § 1191

1. Projected disposable income under 11 U.S.C. § 1191(c)(2)(A)
 - a) Plan projections based on Gross Sales? Income? Cash Flow? What do creditors/courts look at in determining whether an amendment is appropriate?
 - b) Courts have recognized that a debtor's request to modify a plan under 11 U.S.C. § 1193(c) (modification following substantial consummation of a plan “at any time within 3 years, or such longer time not to extend 5 years, as fixed by the court”) is a “fact-intensive inquiry.” *In re Samurai Marital Sports, Inc.*, 644 B.R. 667 (Bankr. S.D. Tex. 2022). In *Samurai Marital Sports*, the sub v debtor sought modification of its confirmed nonconsensual plan under Section 1193(c) in order to defer three monthly payments under the plan, to resume payments in the fourth month, and to cure the accrued arrearage over the course of the plan.

Amending a Plan Post-Confirmation

- c) The subchapter V trustee and a creditor objected. The court sustained the objections and denied the debtor's motion to modify its plan. The court found that, under Section 1193(c), such modification must be warranted by the circumstances, a fact-intensive inquiry. These circumstances must include unforeseen circumstances (i.e. not the result of any unjustifiable or culpable acts or omissions from the debtor) that render the confirmed plan unworkable, a standard often employed under section 1127(b). Such modification must also meet all confirmation requirements of a subchapter V plan, including those found in section 1191, which the debtor failed to meet in numerous respects.
- d) Question for discussion: What would be insufficient justification for amending a plan?

Part II: Pitfalls



**Poor Monitoring,
Insufficient Reporting, Default,
and Other Missteps**

Default Language

1. Default language in plan varies case to case
2. Small business and subchapter V cases
 - a) Discussion points:
 - i. Is there a difference?
 - ii. How has Sub V default language evolved?
 - iii. Interplay of § 1191(c)(3) and § 1191(b)

Default Language Subchapter V II Cases

11 U.S.C. § 1191(c)(3) requires that for a subchapter V plan to be considered “fair and equitable” – an obligation under § 1191(b)’s cramdown provision - the debtor must show that: “(A) [t]he debtor will be able to make all payments under the plan; or (B)(i) there is a reasonable likelihood that the debtor will be able to make all payments under the plan; and (ii) the plan provides appropriate remedies, which may include the liquidation of nonexempt assets, to protect the holders of claims or interests in the event that the payments are not made.”

The Bankruptcy Threshold Adjustment and Technical Corrections Act (signed in June 2022) is best known for extending the \$7.5 million debt cap for Sub V cases, but it also amended § 1191(c)(3) to clarify that the “appropriate remedies” section applies only in circumstances where a debtor is merely able to show a “reasonable likelihood” of being able to make all plan payments, rather than showing that it “will” be able to make all plan payments.

Default Language Subchapter V II Cases (contd)

Therefore, if the debtor can show that it “will be able to make all payments” under its plan, there is no need to provide “appropriate remedies” in its plan in order to satisfy § 1191(c)(3)’s “fair and equitable” requirement. This is an important threshold issue. If, however, a debtor is not able to demonstrate to the Court that it “will be able to make all payments” under its plan, the debtor must provide “appropriate remedies” in its plan. In interpreting what is an “appropriate remedy,” at least one court has found that general language may not suffice. *See In re Channel Clarity Holdings LLC*, Case No. 21-07972, 2022 WL 3710602 (Bankr. N.D. Ill. July 19, 2022).

Default Language Subchapter V II Cases (contd)

For example, language that simply stated “the particular claimant shall be entitled to pursue its remedies as are available to it pursuant to applicable law” was a “toothless remedy” that failed to provide specific protections for unsecured creditors who are forced to forgo some of the standard protections of a typical chapter 11 case when debtors elect to proceed under subchapter V. *Id.* at *16.

In order to meet the “appropriate remedy” requirement, the Channel Clarity court suggested that an amended plan might offer options “such as expedited liquidation of nonexempt assets, or a truncated process for declaring a default and allowing collections to begin, or immediate conversion to allow a chapter 7 trustee to take over business operations and possibly conduct a winddown and liquidation.” *Id.*

Default Language Subchapter V II Cases (contd)

Compare *In re Ellingsworth Residential Cmty. Ass'n, Inc.*, No. 6:20-bk-01346-KSJ, 2021 WL 6122645, at *2 (Bankr. M.D. Fla. Oct. 16 2020) (deeming sufficient the debtor's default remedy providing “for a ten day cure period, and should the Debtor fail to cure, the claimholder may seek relief from this Court to enforce the Plan or seek relief available under federal or applicable state law”); *In re Urgent Care Physicians, Ltd.*, 2021 WL 6090985 at *11 (finding debtor's proposed default remedy providing that “the case will remain open and those creditors may seek relief in this Court based on the debtor's default under the plan” to be satisfactory).

Remedies

Is conversion always in the creditors' best interest or are there more attractive alternatives?

Conversion, Dismissal or Other

What evidence is needed to convert to a Chapter 7?

Under what circumstances might a bankruptcy case be dismissed post-confirmation?

Other – can confirmation order be revoked if procured by fraud pursuant to 11 U.S.C § 1144.



Strategies for Dealing with Disputes

Third Party Releases, Exculpatory Clauses and the Gatekeeping Function

To induce sophisticated and necessary parties to transact in Chapter 11, those parties often require releases or, at a minimum, limitations on their and their agents and advisors' liability to claims.

Typically, those protections include releases and exculpation provisions in plans of reorganization.

In addition, plans occasionally require the bankruptcy court to act as a gatekeeper by screening for colorability any claims against the protected parties.

Gatekeeper provisions provide the mechanism for parties to bring post-confirmation claims and issues before the bankruptcy court.

Without exculpation and gatekeeper provisions, none of the key parties will participate in a Chapter 11 case, especially where the case is paralyzed by a litigation culture.

These strategies for dealing with disputes and plan protections are necessary to the success of a debtor's plan.

Third Party Releases

- When a debtor confirms a chapter 11 plan, section 1141 of the Bankruptcy Code allows the debtor to discharge its liabilities. The discharge, however, is limited to the debtor, and section 524(e) of the Bankruptcy Code specifically provides that the discharge does not affect the pre-confirmation liability of non-debtor entities.
- Typically, chapter 11 plans contain releases for third parties from claims related to the debtor or the restructuring process. Although limited in scope, these releases have an effect similar to a discharge and are often critical to a plan's confirmation.
- Essential plan participants, such as DIP lenders and exit financing lenders, would be unlikely to participate in a chapter 11 case without a protection against certain third-party claims. Similarly, other non-debtor parties that provide a substantial contribution to a restructuring often seek releases in exchange for those contributions.
- Without approval of these third-party releases, non-debtor parties who participate in a chapter 11 case would not receive the benefit of the bargain they struck for providing critical funding, significant efforts, and making concessions and accommodations during the chapter 11 process.

Third Party Releases – Consent or No Consent

- Given the number of non-debtor parties that contribute to a restructuring, and the substantial impact of a release on the rights of creditors and equity holders, bankruptcy courts focus heavily on which parties are bound by third-party releases. Courts agree that third-party releases are binding on those creditors and equity holders that consent to such releases but deviate on what constitutes consent.
- Several bankruptcy judges have ruled that creditors and equity holders consent to third-party releases if they do not opt out of the releases contained in the plan solicitation materials, even where creditors and equity holders abstain from failing to vote or otherwise submit a ballot indicating whether they are opting out of the releases.
- Procedurally, creditors and equity holders typically receive solicitation materials consisting of a ballot or a notice of non-voting status which contains an opt-out selection box. Those who do not check the box and return the ballot or opt-out form are deemed to have consented to the third-party releases contained in the plan.
- These courts have reasoned that clear and conspicuous instructions contained in the solicitation materials about how to opt out of granting third-party releases provide sufficient information and opportunity such that creditors and equity holders that fail to opt out (including through abstention) have consented to the release.

Third Party Releases – Consent or No Consent

- Other judges have looked at opt-out mechanisms more doubtfully. These courts have ruled that a third-party release is effective only with respect to those who affirmatively consent to it by affirmatively voting in favor of a plan or returning a ballot or opt-out form and not opting out of the third-party releases. Unlike other courts, abstention by failure to return a ballot or opt-out form is not a sufficient manifestation of consent to a third-party release.
- The law, therefore, is unsettled. Although each case is fact-dependent, whether the court views third-party releases as consensual has a significant impact on the stakeholders participating in a chapter 11 case and advancing the chapter 11 plan confirmation process.
- While the majority of bankruptcy judges agree that opt-out mechanisms may be used to determine the deemed consent of nonresponsive creditors and equity holders, there remains a minority view that requires debtors to show that classes bound by third-party releases have affirmatively consented to provide such releases. Consequently, there is likely to be continued uncertainty on this key issue, and it will affect debtors and potential plan participants whose contributions to a restructuring may be dependent on the assurance of third-party releases.

Nonconsensual, Non-debtor Releases in Sub V Cases

There appears to be only one court with a published an opinion regarding the application of nonconsensual, nondebtor releases in the context of a sub v case. In that opinion, the district court disallowed such releases, reversing the bankruptcy court who permitted the releases in the debtor's plan. In the *Hal Luftig Company, Inc.* case (24-cv-166), Judge Denise Cote rejected the bankruptcy court's report and recommendation and denied confirmation of the plan. The plan proposed giving the debtor's owner a release from liability on a \$2.9 million arbitration award held by one of the debtor's investors, FCP Entertainment Partners, LLC ("FCP").

Nonconsensual, Non-debtor Releases in Sub V Cases (cont'd)

In exchange for the release, the plan required the owner to supply \$600,000 toward payments to creditors. FCP was literally in a class by itself under the plan and voted against the plan, forcing the debtor to attempt to confirm the plan under Section 1191(b)'s cramdown provision. On the “threshold question” of whether nondebtor releases are proper in subchapter v cases, Judge Cote cited Second Circuit precedent (*In re Metromedia Fiber Networks Inc.*, 417 F.3d 136 (2d Cir. 2005)) noting that the release of claims held by nondebtors against other nondebtors is a “dramatic measure to be used cautiously” and “is proper only in rare cases.” *Id.* at 141. Judge Conte also relied on the “seven factor test” for considering nonconsensual, nondebtor releases outlined by the Second Circuit in *Purdue Pharma LP v. City of Grand Prairie (In re Purdue Pharma LP)*, 69 F.4th 45, 79 (2d Cir. May 40, 2023).

Nonconsensual, Nondebtor Releases in Sub V Cases (cont'd)

While the bankruptcy court conceded that the sixth Purdue factor was not satisfied, the court gave “little” weight to this factor observing that this is a subchapter v case and, as such, confirmation of the plan may occur without the consent of any creditor. The district court reversed, finding that the bankruptcy court’s reasoning on this point was misplaced and that the court failed to properly apply all of the Purdue factors. The district court found that the bankruptcy court’s holding that “the Plan is the best possible means of enabling FCP’s recovery” and that there will be no “tangible financial harm” with approval of the third-party release was “clearly wrong” as FCP would recover at most approximately \$1 million on its \$2.8 million claim. *Id.* at 10.

Exculpation Clauses

- Chapter 11 plans commonly protect a debtor's key stakeholders that participate in the chapter 11 process from claims arising in connection with the bankruptcy case.
- In chapter 11 cases, exculpation clauses are often approved in the ordinary course as an exercise of the Debtor's business judgment. These provisions are customarily limited to specific claims that could arise in connection with the chapter 11 case, including plan negotiation and implementation. Liabilities arising from gross negligence, fraud and willful misconduct are typically carved-out of plan exculpation provisions.
- Exculpation provisions are typically limited to key parties in the plan formulation process, such as the debtors, any official committee, certain lenders or security holders, and their related parties. In practice, exculpation provisions create a higher standard of liability for any claims against exculpated parties that relate to their participation in the chapter 11 case. These provisions are intended to induce important stakeholders to take an active role in the plan formulation process in order to maximize value in a debtor's chapter 11 case.

Exculpation Clauses

However, in *Pacific Lumber*, the Fifth Circuit held that section 524(e) of the Bankruptcy Code precluded the exculpation and third party releases in that case. As stated earlier, Section 524(e) of the Bankruptcy Code provides that the “discharge of a debt . . . [in a chapter 11 proceeding] does not affect the liability of any other entity on . . . such debt.” The Fifth Circuit interpreted this section as prohibiting the effective release of claims against non-debtor exculpated parties. It therefore denied the proposed exculpation provision as drafted, retaining only a narrow exculpation for the official unsecured creditors’ committee and its members which the Court regarded as statutorily empowered to act for the benefit of the debtors and their estates.

Following *Pacific Lumber*, the Ninth Circuit in *Blixseth* distinguished the Fifth Circuit’s rationale. Referencing *Pacific Lumber*, the Ninth Circuit noted that section 524(e) of the Bankruptcy Code does not bar a customary exculpation (i.e., one limited to separate claims arising for acts or omissions in connection with the chapter 11 cases and the filing and solicitation of the plan). The court further held that a typical exculpation provision does not implicate section 524(e) of the Bankruptcy Code at all, because it only applies to claims arising from the bankruptcy proceeding itself and does not impermissibly absolve a co-debtor or guarantor’s liability on a discharged debt.

Exculpation Clauses

- Courts have been confronted with objections to plan exculpation provisions, arguing, among other things, that only a statutory committee and its members may be exculpated under *Pacific Lumber*.
- In response, many debtors have argued that standard exculpation provisions are properly included in chapter 11 plans as a matter of the debtor's business judgment to ensure that necessary parties, including parties other than the committee and its members, participate in the debtor's chapter 11 plan.
- Bankruptcy courts have generally agreed with these debtors noting that exculpation clauses appropriately cover prepetition and post-petition acts by key stakeholders that directly relate to the bankruptcy case.
- Many of these courts acknowledge that exculpated parties, including non-estate fiduciaries, add value to the restructuring process and that plan exculpation provisions reward parties for doing so.
- The scope and use of exculpation provisions in plans will continue to evolve. The provisions are necessary to induce parties to participate in the plan process. At the same time, however, there is caselaw supporting a narrowing of the exculpation provision and those parties that benefit from it.

Gatekeeper Function

- Gatekeeper provisions in Chapter 11 plans may provide an alternative to non-consensual non-debtor releases.
- As many practitioners are aware, there is a circuit split with respect to the allowability of non-consensual third-party releases. Notably, in the *Purdue Pharma* case, the Second Circuit held that bankruptcy courts have the authority to approve plans with non-consensual releases of direct third-party claims against a non-debtor.
- The Third, Fourth, Sixth, Seventh, and Eleventh Circuits have allowed such third-party releases in Chapter 11 bankruptcy plans. The Fifth, Ninth, and Tenth circuits have expressly disallowed non-consensual third-party releases.
- The question of whether non-consensual third-party releases are permissible under the Bankruptcy Code is now before the U.S. Supreme Court. The Supreme Court previously issued an order putting the *Purdue Pharma* bankruptcy confirmation on hold so that it can address the validity of non-consensual third-party releases. The Supreme Court is expected to issue a decision in June 2024.

Gatekeeper Function

- Gatekeeping is not a release. Rather, it is an injunction preventing lawsuits against critical plan participants before the bankruptcy court determines whether there is a “colorable claim” that it or some other court will adjudicate.
 - Example - Gatekeeper Function: In the event the Release set forth in paragraph __ becomes effective, all creditors and/or equity holders of _____ shall first be required to seek approval from this Court, which approval shall be sought by motion prior to asserting any request, claim, or cause of action, including but not limited to, causes of action for contribution or indemnification, however denominated, against any Released Party in this Court (and not in any other forum). If such a motion is filed, the Court shall determine whether such request, claim, or cause of action is released pursuant to the Release set forth above
- While broad releases for non-debtor parties making a monetary contribution to a plan of reorganization, e.g., the Sackler family in *Purdue Pharma*, have drawn significant attention, narrower releases for essential non-debtor plan participants have enjoyed some success, even under a less expansive view of bankruptcy courts’ authority to grant such releases.

Gatekeeper Function

- **Highland Capital – The Fifth Circuit Decision**

The Highland Capital case involved “vexatious litigation” from James Dondero, the investment firm’s founder and former CEO. *Nexpoint Advisors, L.P. v. Highland Capital Mgmt., L.P. (In re Highland Capital Mgmt., L.P.)*, 48 F.4th 419, 426 (5th Cir. 2022).

- The Highland Capital plan proposed an exculpation provision enforced by an injunction and “gatekeeper” provision. The plan’s exculpated parties included the debtor, its employees, its general partner, the independent directors, the creditors’ committee members, successor entities, the oversight board created to monitor plan implementation, retained professionals and “Related Persons.” *Id.* at 427. The bankruptcy court, as the gatekeeper, would (i) determine whether any party seeking to bring a claim against an exculpated party had a “colorable claim,” (ii) authorize the party to bring the claim, and (iii) adjudicate the claim if the bankruptcy court had jurisdiction over the merits. *Id.*
- The Fifth Circuit approved the gatekeeping provision as a function that bankruptcy courts traditionally perform. While not a release, the Fifth Circuit approved the gatekeeper and injunction, which could limit improper suits against chapter 11 insiders while still preserving the plaintiff’s right to assert claims.

Gatekeeper Function

- In August, 2023, the U.S. Bankruptcy Court for the Northern District of Texas exercised the gatekeeping provisions in the Highland Capital plan by denying Hunter Mountain Investment Trust (controlled by Dondero) leave to file a complaint against the debtor's CEO James Seery and others.
- The proposed complaint alleged that Seery breached fiduciary duties and conspired to induce unsecured creditors to sell their claims at a discount to purchasers, allegedly friendly to Seery, who would approve of Seery's allegedly excessive compensation demands, and that the discounted sale resulted in less money to pay off the creditor body in full and diminished the likelihood that HMIT will realize any recovery on its contingent former equity interest. *In re Highland Capital Mgmt., L.P.*, No. 19-34054-sgj-11, 2023 Bankr. LEXIS 2104, at *58 (Bankr. N.D. Tex. Aug. 25, 2023).
- The Bankruptcy Court held a full-day evidentiary hearing admitting more than 80 exhibits and receiving testimony from Seery, Dondero and HMIT's administrator. *Id.* at 72. The Bankruptcy Court concluded that HMIT lacked standing to bring the proposed claims and that, even if HMIT had standing, it "has not met its burden under the Gatekeeper Colorability Test of showing that ... the Proposed Claims are not without foundation, not without merit, and not being pursued for an improper purpose." *Id.* at 155.

Gatekeeper Function

In December 2023, at the Cyxtera Technologies (“Cyxtera”) confirmation hearing held before Judge Sherwood in the United States Bankruptcy Court for the District of New Jersey, the United States Trustee objected to the plan’s releases and exculpation provisions as overbroad due to including affiliates and related parties. After clarification regarding the definition of “related parties” and addressing other concerns related to consideration, opt outs, and mutuality of releases, Judge Sherwood confirmed the Cyxtera plan.

It appears that Judge Sherwood gained some comfort allowing the releases, in part because the Plan included a gatekeeper provision. As set forth above, gatekeeper provisions require parties to come to the bankruptcy court to determine if their claims are subject to the release, exculpation, and injunction provisions prior to pursuing claims that may be subject to the release, injunction, and exculpation provisions of the Plan.

The gatekeeper provisions are designed to address the concern that parties may not have read the releases in the plan, particularly the requirement to affirmatively opt out of the plan’s releases.

Gatekeeper Function

In the RTW Retailwinds case, Judge Sherwood expressed concern with lack of mutual consideration in a plan's releases, stating that a release where a party is not receiving any consideration is not a "meaningful release" and is not "essential to the plan." However, Judge Sherwood modified his position in Cyxtera, in part due to the circumstances (notably the absence of any creditor that voted to reject the plan but failed to opt out of the releases), but also due to the gatekeeping provision included in the plan. He also noted the fact that 190 equity investors holding 5.8 million shares selected the opt out as "evidence that the process functions" and that various groups, including the debtors, the unsecured creditors committee, the ad hoc secured creditor group, and a special committee of the debtors' board of directors, all with counsel and advisors, examined potential claims against the proposed "released parties" and "found none worth pursuing."

Gatekeeper Function

Finally, in response to the United States Trustee's argument that the gatekeeping provisions foists an unnecessary extra step and expense upon parties to have to come to the bankruptcy court first, Judge Sherwood responded by stating that parties should want to come back to the bankruptcy court to get clarity in the first instance if they are violation the plan's injunction.

While Judge Sherwood was not comfortable presuming that everyone read and understood the releases and the opt out provision, and he understood the concern regarding a hypothetical claimant that is unsophisticated or that failed to read their mail, but if such a person exists, they can use the gatekeeper process in the plan to plead their case.

In re RTW Retailwinds Inc. et al., Case No. 20-18445-JKS, Docket No. 690.

Similarly, Chief Judge Kaplan in New Jersey recently confirmed a plan with similar "gatekeeping" provisions in the *BlockFi* case.

In re BlockFi Inc. et al., Case No. 22-19361 -MBK, Docket No. 1660, ¶ 18.

Gatekeeper Function

Debtors may consider adding gatekeeper provisions to their plans, especially with the uncertainty pending the Supreme Court's decision in *Purdue Pharma*. Adding a gatekeeper provision is a form of protection that, if a release of an essential chapter 11 participant is unenforceable, can prevent improper litigation against plan participants.

Thank you