Business Reorganization Committee

ABI Committee News

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Indianapolis Downs: No Hard and Fast Rule on Third-Party Releases

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A recent decision from the U.S. Bankruptcy Court for the District of Delaware highlights the continuing difficulty that a debtor may face when drafting release language for its chapter 11 plan. In *In re Indianapolis Downs LLC*,[1] the court confirmed the debtor's chapter 11 plan over the objection of the U.S. Trustee and other creditors, which proposed to bind creditors to certain third-party releases unless they affirmatively opted out of granting such releases. As a result, creditors who abstained from voting or otherwise failed to opt out of granting such releases were deemed to consent to the plan's third-party releases.

The debtors in *Indianapolis Downs LLC* operated a combined horse track and casino. In 2011, they filed for bankruptcy protection after struggling to meet their debt service and failing to successfully negotiate a restructuring plan with their lenders. As is customary in most chapter 11 cases, the debtors' plan provided for certain third-party releases. Creditors holding claims against the debtors could opt out of granting the releases by checking the appropriate ballot box and returning the ballot to the debtors' claims agent. The plan further provided that the third-party releases would apply to those holders of claims who (1) affirmatively voted in favor of the plan and did not opt out of granting the releases; (2) had unimpaired claims and were deemed to accept the plan pursuant to § 1126(f) of the Bankruptcy Code; and (3) did not submit a ballot or otherwise opt out of the releases.

The U.S. Trustee objected to the confirmation of the debtors' plan on the basis that, among others, third-party releases should not bind parties who abstained from voting or did not otherwise opt out of the releases. The U.S. Trustee argued that such third-party releases could only be granted upon a creditor's affirmative consent and that the debtor's plan would essentially force those creditors who abstained from voting or did not otherwise opt of the releases to involuntarily grant the releases. One of the issues before the bankruptcy court in the *Indianapolis Downs* case was therefore whether a creditor's affirmative consent is required to grant third-party releases.

The court began its analysis by reviewing applicable case law in the Third Circuit. In the Third Circuit, as well as in most jurisdictions, plans may provide for third-party releases upon the consent of the affected party. To support its position, the bankruptcy court referenced *In re Zenith Elecs. Corp.* and *In re Spansion Inc.*, two Delaware cases in which the court found that nondebtor releases may be included in a debtor's plan if the release is consensual.[2] However, the bankruptcy court found that a flexible approach should be used when determining whether a third-party release is consensual.[3]

The bankruptcy court determined that the deemed acceptance by the unimpaired creditors was permissible because such creditors were being paid in full and had therefore received consideration in exchange for the grant of the release. The court further found that with respect to the impaired creditors "who abstained from voting on the Plan, or who voted to reject the Plan and did not otherwise opt out of the releases, the record reflects [that] these parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots."[4] Impaired creditors who abstained from voting on the plan or did not otherwise opt out of the third-party releases therefore "consented" because they failed to take any action despite knowing the consequences of such passivity. For that reason, the bankruptcy court approved the third-party releases on the basis that they were consensual.

The court's decision clashes with *In re Washington Mutual Inc.*,[5] a Delaware case in which Hon. Mary F. Walrath found that a creditor must affirmatively consent to a third-party release in order for such release to be effective. In that case, Judge Walrath opined that "[f]ailing to return a ballot is not a sufficient manifestation of consent to a third-party release."[6] The bankruptcy court acknowledged the ruling of the *Washington Mutual* case but found that there was no "hard and fast rule" that makes third-party releases unenforceable without affirmative consent.[7] Rather, the court emphasized that the flexible approach used for the evaluation of third-party releases has been successfully used in other jurisdictions.[8]

The *Indianapolis Downs* case serves as useful reminder that courts—and even judges sitting on the same court—often do not see eye to eye when it comes to confirmation issues and specifically the granting of releases under chapter 11 plans.

Going forward, only time will tell whether the more flexible approach to consensual releases will be used by courts facing this issue. One can only hope that courts will eventually come together to provide a uniform standard on the degree of creditor consent required for the effective grant of third-party releases.

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

2. *In re Zenith Elecs. Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999); *In re Spansion Inc.*, 426 B.R. 114 (Bankr. D. Del. 2010).

3. *Indianapolis Downs*, 486 B.R. at 305.

4. *Id*. at 306.

5. *In re Washington Mutual Inc.*, 442 B.R. 314 (Bankr. D. Del. 2011).

6. *Id.* at 355.

7. *Indianapolis Downs*,486 B.R. at 305.

8. *Id.* ("Courts in other jurisdictions have similarly taken a more flexible approach in evaluating whether a third-party release was consensual, finding that even impaired creditors who abstained from voting on a plan and did not otherwise opt out were nevertheless bound.").