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# Client Alert

Financial Restructuring Practice Group

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## Eleventh Circuit Sides with Majority in Approving Third Party Releases in Bankruptcy Plans

On March 12, 2015, the United States Court of Appeals for the Eleventh Circuit affirmed the authority of a bankruptcy court to issue non-consensual, non-debtor releases in connection with the confirmation of a plan of reorganization.[1] With this decision, the Eleventh Circuit joined the majority view that such releases are permissible under certain circumstances.

### Background

Seaside Engineering and Surveying, LLC (the "**Debtor**") filed for Chapter 11 bankruptcy relief on October 7, 2011. The Debtor filed a reorganization plan that provided for the release by the Debtor's creditors of certain non-debtor parties, including the principals of the Debtor, for any acts or omissions "in connection with, relating to, or arising out of" the Debtor's Chapter 11 case or plan of reorganization (the "**Release**").[2]

SE Property Holdings, LLC and Vision-Park Properties, LLC (collectively, "**Vision**"), creditors of certain of the releasees, objected to the plan and the Release. The bankruptcy court approved the Debtor's plan, and the district court affirmed that decision. Vision promptly appealed to the Eleventh Circuit and argued that the Release violates the Bankruptcy Code.

### Eleventh Circuit Opinion

The circuit courts are split on the issue of whether non-consensual third party releases are permissible under the Bankruptcy Code. The Fifth, Ninth, and Tenth Circuits hold that the Bankruptcy Code prohibits such releases.[3] These courts base their position on Section 524(e) of the Bankruptcy Code, which provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on" such debt. However, the majority of circuits—the Second, Third, Fourth, Sixth, and Seventh Circuits—hold that such releases are permissible under certain circumstances.[4] These courts conclude that Section 524(e) speaks only to the effect of a discharge, but says nothing about the authority of a bankruptcy court, under other provisions of the Bankruptcy Code (*e.g.*, Section 105(a)), to release non-debtors from claims.

In *Seaside Engineering*, the Eleventh Circuit embraced the majority view that non-consensual, non-debtor releases are permissible. However, the Court noted that a non-debtor release should "not be issued lightly, and should be

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reserved for those unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable."[5] The Court suggested that bankruptcy courts should consider the non-exclusive factors set forth in *In re Dow Corning*, in which the Sixth Circuit held that a non-debtor release (along with an injunction enforcing such release) is appropriate 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.[6]

Applying these factors, the Eleventh Circuit concluded that the bankruptcy court did not abuse its discretion in approving the Release because: (a) the "reorganized entity's business is completely dependent upon the skilled labor of the releasees"; (b) the releasees are contributing substantial services to the reorganized entity; (c) without the Release, the litigation against the principals would continue and "dash any hope for a successful reorganization"; and (d) under the plan, Vision is being paid in full for its interests. Additionally, the Court deemed the Release to be "fair and equitable" because it was "narrowly limited" to claims "arising out of the Chapter 11 case."[7]

**Conclusion**

The Court's opinion in *Seaside Engineering* places the Eleventh Circuit firmly on the side of the majority of circuits, which view non-consensual, non-debtor releases as permissible in certain circumstances. Emphasizing that these types of releases should be granted sparingly, *Seaside Engineering* provides helpful guidance with respect to the factors that courts (and parties) should consider when evaluating non-debtor releases.



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[1] *SE Prop. Holdings, LLC v. Seaside Eng'g & Surveying, Inc. (In re Seaside Eng'g & Surveying, Inc.)*, Case No. 14-11590, 2015 U.S. App. LEXIS 3831, at *1–*2 (11th Cir. Mar. 12, 2015).

[2] *Id.* at *6.

[3] *Id.* at *11–*12 n.6. (citing cases).

[4] *Id.* at *11–*12 n.7, n.8 (citing cases) (noting that the First and D.C. Circuits have indicated that they agree with the majority view).

[5] *Id.* at *13–*14.

[6] *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002).

[7] *Seaside Eng'g*, 2015 U.S. App. LEXIS 3831, at *15–*22.