



*91st Annual National Conference of Bankruptcy Judges*

**October 8-11, 2017**

**Las Vegas, NV**

**Effective Use of Non-Debtor Third Party Releases**

**Presenters**

**Hon. Margaret M. Mann, U.S. Bankruptcy Court, Southern District of California, Moderator**

**Abid Qureshi, Partner, Akin Gump Strauss Hauer & Feld LLP, New York, NY**

**Paul Rundell, Managing Director, Alvarez & Marsal, Healthcare Industry Group, Chicago, IL**

**Clifford J. White III, Director, U.S. Trustee Program, Department of Justice, Washington DC**



## *Introduction to Sandbox, Inc.*

- Sandbox, Inc.'s officers and board members (“Insiders”) face allegations of breach of fiduciary duties
- Sandbox files a chapter 11 case to reorganize its balance sheet and deal with alleged prepetition claims
- Chapter 11 is rocky - Insiders now face allegations of postpetition breach of fiduciary duties
- Creditors' Committee conducting an investigation of all pre and postpetition claims
- Distressed debt investors holding subordinated debt ("Subdebt") threaten litigation
- Although many threats of litigation, no complaints filed



## *Sandbox, Inc.'s Chapter 11 Plan*

- Sandbox files a plan of reorganization ("Plan") supported by the Insiders that proposes to convert senior secured debt ("Senior Debt") to equity pursuant to a Plan Support Agreement ("PSA") signed by Sandbox, the Senior Debt, and certain critical trade creditors (not Committee members)
- Plan contains:
  - Standard plan injunction provision
  - Exculpation provision for parties to the PSA, the Insiders, and their respective professional and other advisors
  - Broad releases for Sandbox, the Insiders, and the Senior Debt of all prepetition claims held by all Sandbox creditors ("Third Party Release")
  - No release of alleged postpetition claims for breach of fiduciary duties



## *Sandbox, Inc.'s Chapter 11 Plan*

- Disclosure statement filed with the Plan:
  - Description of the Third Party Release only includes generic conclusory statements and does not discuss details regarding the released parties and the releasing parties
  - Third Party Release description does not discuss details regarding the claims released
  - Description of exculpation broadly written to include any and all actions by PSA parties and Insiders during the chapter 11 case
- Insiders do not contribute assets to the Plan



## *Question No. 1*

The Committee proposes to settle its objection to the Third Party Release in exchange for the Insiders' contribution to a Liquidation Trust that will fund a meaningful recovery to the unsecured creditors

- You represent the Insiders, what advice do you give?
  - A. Stonewall the Committee and seek approval of the Plan over the Committee's objection
  - B. Obtain a valuation of alleged claims against the Insiders as a basis to negotiate an agreed-upon Insider contribution



## *Question No. 2*

The US Trustee joins the Subdebtor's objection to the Third Party Release, arguing that it violates the Bankruptcy Code

- What is the US Trustee's best argument opposing the Third Party Release?
  - A. The Insiders gave no consideration in exchange for the release
  - B. The disclosures relating to the third party claims were inadequate
  - C. Bankruptcy Code section 524(e) prohibits the bankruptcy judge from entering orders releasing non-debtor third parties
  - D. Third party releases require consent from the affected class, which was not given here
  - E. Scope of the released parties (i.e., Sandbox, Insiders and Senior Debt) under the release is too broad



## *Question No. 3*

The venue of Sandbox, Inc.'s bankruptcy case is unknown

- Which bankruptcy court in the following jurisdictions do you believe is most likely to approve the Third Party Release?
  - A. District of Delaware (Wilmington, DE)
  - B. Northern District of Illinois (Chicago)
  - C. District of Nevada (Las Vegas)
  - D. Southern District of New York (Manhattan)



## *Question No. 4*

- The Insiders settle the Committee's objection to the Plan and agree to contribute \$4 million in consideration of the Third Party Release
- The Subdebt continues to object, arguing that its expert values the prepetition breach of fiduciary duty claims against the Insiders at \$10 million
- D&O policy is \$5 million and there are collection issues beyond the insurance policy
- Sandbox's financial advisor testifies about the sufficiency of the Insiders' consideration



## *Question No. 4 (cont.)*

- If you are the bankruptcy judge, what fact is most significant to you in evaluating the sufficiency of the Insiders' \$4 million dollar consideration in exchange for the Third Party Release?
  - A. All classes, except the Subdebt, voted in favor of the plan
  - B. The Committee supports the plan
  - C. The Subdebt expert's valuation of the alleged claims, opining that after considering costs and risk of collection and limited insurance proceeds, the value of the released claims is not significantly more than the Insiders' contribution



## *Question No. 5*

- The US Trustee persists in its objection to the Third Party Release, primarily arguing lack of consent
- Sandbox acquiesces and modifies the Plan to provide for consent of the Third Party Release through the ballot
- Which establishes consent of the Third Party Release?
  - A. Return of a ballot checking "opt-in" to the release box
  - B. Return of a ballot voting against the Plan and leaving unchecked "opt-out" to the release box
  - C. Return of a ballot voting in favor of the Plan and leaving unchecked "opt-out" of the release box
  - D. Any of the above



## *Question No. 6*

- The Subdebt persists in its objection to the Third Party Release, now also arguing that, under *Stern v. Marshal*, the bankruptcy judge lacks jurisdiction to enter the confirmation order (i.e., a final order) authorizing the Third Party Release
- May the bankruptcy judge enter a confirmation order authorizing the Third Party Release?
  - A. No, the bankruptcy judge lacks jurisdiction to authorize the Third Party Release
  - B. Yes, if the class impacted by the Third Party Release voted in favor of the Plan?
  - C. Yes, but the Third Party Release would only be binding on creditors that expressly consented to the plan as that would be deemed consent under *Wellness*



## *Question No. 7*

- The Subdebt also objects to the exculpation clause, which was amended as part of the Committee settlement to include the Committee and its members
- Amended exculpation clause enjoins any actions against Sandbox, the Insiders, the Senior Debt, certain trade creditors under the PSA, the Committee, and its members, and their respective professionals and advisors for all actions and decisions made during the chapter 11 case



## *Question No. 7 (cont.)*

- Should the exculpation clause be approved?
  - A. Yes, broad exculpation provisions are standard and expected in every case for parties that actively participate in formulating and eventually consummating the Plan
  - B. Yes, but only for estate fiduciaries. The Insiders, Senior Debt and trade creditors under the PSA should be stricken from the exculpation clause
  - C. No, there was no independent consideration given by the Insiders or non-estate fiduciaries



## *Question No. 8*

- Sandbox's case is pending in a jurisdiction that only approves non-consensual third party releases in "rare and unusual circumstances"
- While the Plan receives broad support during solicitation, the Subdebt continues to object to the Third Party Release and would be bound if the release is approved
- The bankruptcy court indicates it is likely to approve the Plan, but takes it under advisement
- Before a final decision is entered, *Czyzewski v. Jevic Holding Corporation* (Jevic) is decided



## *Question No. 8 (cont.)*

- May the bankruptcy court (post Jevic) confirm the Plan including the Third Party Release if the Plan otherwise met the "rare and unusual circumstances" requirements?
  - A. Yes
  - B. No