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WHAT'S INSIDE

JURISDICTION

Supreme Court hears argument on debtor's right to appeal bankruptcy plan denials

By Ken Bradley, Senior Legal Writer, Westlaw Journals

The U.S. Supreme Court heard argument April 1 about whether the Bankruptcy Code allows direct appeals by a debtor from the denial of a Chapter 13 plan.

Bullard v. Blue Hills Bank, No. 14-116, oral argument held (U.S. Apr. 1, 2015).

"The potential ramifications for Chapter 11 reorganizations could not be greater," said **Rob Nies**, a bankruptcy attorney with **Wolff & Samson**.

"The justices were impressively concerned with a potential shift in bargaining power during the negotiated plan process," according to Nies, who is not involved in the case.

Bankruptcy attorney **Sherri L. Dahl** of **Roetzel & Andress**, who is not involved in the case, said a ruling for the debtor here would promote fairness.

"Allowing debtors to appeal plan denials will level the playing field because creditors are able to seek immediate appellate relief when plans are confirmed," Dahl said.

DEBTOR'S TROUBLES

Louis Bullard filed a voluntary Chapter 13 petition in the U.S. Bankruptcy Court for the District of Massachusetts in 2010. Creditor Hyde Park Savings Bank, now known as Blue Hills Bank, presented a proof of claim for about $350,000 based on a mortgage on Bullard's real property that both parties agreed was worth substantially less.

REUTERS/Joshua Roberts

Bullard proposed a plan that involved a hybrid payment scheme. The plan divided his debt into a secured claim backed up by the real estate and

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COMMENTARY

Ex culpa or *mea culpa*: The use of exculpation provisions in bankruptcy plans

Attorney John B. Butler III offers advice for bankruptcy attorneys who draft exculpation provisions in light of the increasing number of Chapter 11 cases that include such provisions in their plans.

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Ex culpa or *mea culpa*: The use of exculpation provisions in bankruptcy plans

By John B. Butler III

"Exculpated party" — while it does not seem like a salubrious appellation to which many would aspire, and in fact sounds menacingly painful — such is not the case. From the increasing number of cases dealing with "exculpation provisions" in Chapter 11 plans, it is obvious many parties in bankruptcy cases fervently desire to be exculpated.

Though similar to a non-debtor, third-party release, an exculpation provision is a more limited release of liability of certain non-debtor parties (usually professionals, employees or committees) who participated in the bankruptcy case. An exculpation provision only addresses liability for actions taken in connection with the bankruptcy case and does not attempt to release the exculpated parties from non-bankruptcy acts taken before or after the bankruptcy filing.

In a footnote to its *National Heritage Foundation* opinion, the 4th U.S. Circuit Court of Appeals clearly distinguished between the third-party releases in the reorganization plan, which were not approved, and the exculpation provision, which was permissible, stating:

> The plan also contained an exculpation provision, barring suits against the released parties for any acts or omissions in connection with the bankruptcy, and an injunction provision, enjoining suits in violation of either the release or exculpation provision. The Bankruptcy Court upheld the exculpation provision ... a decision that neither party challenged. It also approved the injunction provision, but only to the extent that it enforced the exculpation provision and not the release provision. Based on our holding that the release provision is unenforceable, we find no error in that judgment.[1]

In explaining its reasons for approving, on remand, the exculpation provision but not the third-party releases, the Bankruptcy Court in *National Heritage* stated:

> The exculpation provision is limited to acts or omissions taken in connection [with] the bankruptcy case itself. It does not purport to release any pre-petition claims against the officers or directors. Further, ... there is a "gatekeeper" function built into Section 7.21 [of the debtor's fourth amended plan], in that Section 7.21 expressly allows for suits against the released parties if the claimant "obtains the prior approval of the Bankruptcy Court to bring such a claim."
>
> The court finds that the exculpation provision of Section 7.21: (a) is narrowly tailored to meet the needs of the bankruptcy estate; (b) is limited to parties who have performed necessary and valuable duties in connection with the case (excluding estate professionals); (c) is limited to acts and omissions taken in connection with the bankruptcy case; (d) does not purport to release any pre-petition claims; and (e) contains a gatekeeper function by which the court may, in its discretion, permit an action to go forward against the exculpated parties. The court will not disturb the exculpation provisions of Section 7.21.[2]

Other courts have also approved exculpation provisions in Chapter 11 plans, even over the objections of parties, so long as the provisions were not too broad and were consistent with the standard of care expected of the released parties.

> Though similar to a non-debtor, third-party release, an exculpation provision is a more limited release of liability of certain non-debtor parties.

For example, in *In re PWS Holding Corp.*, the 3rd Circuit approved an exculpation provision protecting the officers, directors and employees of the debtors and the reorganized debtors, as well as advisers and professionals, in connection with the confirmation and consummation of the plan, so long as there was no willful misconduct or gross negligence.[3]

The District Court in *In re South Edge LLC* affirmed the Bankruptcy Court's approval of an exculpation provision protecting officers, directors and employees of the debtors and the reorganized debtors, as well as advisers and professionals and lenders.[4] The provision was in connection with the Chapter 11 case, the disclosure statement, the confirmed plan or any document entered into during the Chapter 11 case. The exculpation provision did not cover willful misconduct or gross negligence.

The court in *In re Neogenix Oncology Inc.* approved an exculpation clause that only covered post-petition actions by committee

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members and the debtor's officers and directors who served during the case and excluded claims of gross negligence and willful misconduct.[5]

In *In re Quincy Medical Center* the Bankruptcy Court considered the objection of the U.S. Trustee to the scope of the exculpation clause and approved a modified clause that covered the indenture trustee, the bond owners, the "debtors, creditors' committee, liquidation trustee and their representatives."[6]

In the Chapter 9 case of *In re Connector 2000 Association*, the Bankruptcy Court approved a plan exculpation clause that covered the debtor and its "directors, officers, employees, managers, attorneys, affiliates, agents and professionals (including but not limited to their attorneys, financial advisers, investment bankers, accountants, solicitation agents and other professionals."[7]

In the oft-cited case *In re Yellowstone Mountain Club LLC*, the court approved a broad exculpation provision that stated:

> None of (a) the debtors or the reorganized debtors, (b) the committee, (c) the individual members of the committee in their capacities as such, (d) the DIP [debtor-in-possession] lender, any other lenders of (or participants in) the DIP loan and any agent thereof, (e) the current equity owners, (f) CrossHarbor Capital Partners and all affiliates thereof, (g) the acquirer, and (h) with respect to each of the foregoing persons, each of their respective directors, officers, employees, agents ... representatives, shareholders, partners, members, attorneys, investment bankers, restructuring consultants and financial advisers in their capacities as such (collectively, the "exculpated arties "), shall have or incur any liability to any person for any act or omission in connection with ... the Chapter 11 cases, the formulation, negotiation, implementation, confirmation or consummation of this plan, the disclosure statement, or any ... document entered into during the Chapter 11 cases or otherwise created in connection with this plan.[8]

The court excluded willful misconduct or gross negligence from the exculpation clause.

In light of the extensive negotiations between the parties and the overwhelming acceptance of the plan by the creditors, the court in *In re Winn-Dixie Stores* approved an exculpation provision enjoining any right of action against the "debtors, the reorganized debtors, their respective subsidiaries, the creditors committee, Wachovia, the indenture trustee, or any of their respective present or former members, officers, directors, employees, advisers, professionals, and agents for any matters related to the Chapter 11 case or the plan process except for acts and omissions which are the result of fraud, gross negligence, or willful misconduct."[9]

> Courts have approved exculpation provisions in Chapter 11 plans, even over the objections of parties, so long as the provisions were not too broad and were consistent with the standard of care expected of the released parties.

The court in *In re WCI Cable Inc*. drew a distinction between the exculpation clause for the unsecured creditors committee and its agents and the exculpation clause for other parties such as the trustee, the board of directors, and other professionals and agents.[10] The court was not willing to grant the other parties protection as broad as that granted to the unsecured creditors committee and was willing to approve the exculpation provision for the other parties "only if the exculpation exceptions are extended to cover negligence and breaches of fiduciary duty as well as gross negligence and willful misconduct."

By way of comparison, the court in *In re Washington Mutual Inc*. refused to approve an overly broad exculpation clause, stating:

> [T]he 3rd Circuit has held that a creditors' committee, its members, and estate professionals may be exculpated under a plan for their actions in the bankruptcy case except for willful misconduct or gross negligence. The 3rd Circuit reasoned that such a provision merely stated the standard to which such estate fiduciaries were held in a Chapter 11 case. That fiduciary standard, however, applies only to estate fiduciaries. The debtors' plan goes further and seeks to encompass all the released parties and their related persons. This is either duplicative of the releases granted by the debtors or third parties ... or is an effort to extend those releases. Either way it is inappropriate. The exculpation clause must be limited to the fiduciaries who have served during the Chapter 11 proceeding: estate professionals, the committees and their members, and the debtors' directors and officers."[11]

While most exculpation provisions protect parties who are professionals or employees of the debtor or parties affiliated with a committee, some courts have permitted exculpation clauses to protect parties such as lenders, indenture trustees, bondholders and related property owners.[12] One court disagreed and held it was impermissible to extend the exculpation provisions beyond fiduciaries in the bankruptcy case.[13]

Most courts, often at the suggestion of the U.S. Trustee, draw the exculpatory line in the sand at releasing gross negligence, fraud or willful misconduct.[14]

While *National Heritage* and other cases addressing broad third-party releases and narrower exculpation provisions have approved exculpation provisions rather than broader releases, the drafter of such exculpation provisions would do well to keep in mind the following considerations:

- Limit the exculpated parties to professionals, people affiliated with an official committee, employees and officers of the debtor.
- If you are going to expand the exculpated parties beyond those listed above, include only additional parties that clearly provided financial and other consideration to the bankruptcy estate.
- Limit the scope of the exculpation provisions to post-petition actions taken in connection with the bankruptcy case or particular aspects of the bankruptcy case, such as plan solicitation or plan implementation, and do not include any potential pre-petition claims in the scope of exculpated acts.
- Include a gatekeeping procedure so parties wishing to bring an action covered by the exculpation provisions may file a motion in the bankruptcy

court to be permitted to pursue the otherwise prohibited action.

- Submit evidence at the confirmation hearing which shows the protection is crucial in the plan negotiations and necessary for confirmation of the plan or continued operation of the reorganized debtor. WJ

NOTES

[1] *Nat'l Heritage Found. v. Highbourne Found.*, 760 F.3d 344, n. 2. (4th Cir. 2014) (citation omitted).

[2] *In re Nat'l Heritage Found.*, 478 B.R. 216, 234 (Bankr. E.D. Va. 2012), *aff'd sub nom. Nat'l Heritage Found. v. Highbourne Found.*, 760 F.3d 344 (citations omitted). *See also, In re S. Edge LLC*, 478 B.R. 403, 415-16 (D. Nev. 2012) ("In light of the above authorities, the exculpation provision in Section 8.10 when properly interpreted is within the bankruptcy court's power because the bankruptcy court has exclusive jurisdiction over the parties and their conduct in the bankruptcy proceedings. Section 8.10 sets a standard of care to be applied in the bankruptcy proceeding — a matter which lies within the bankruptcy court's exclusive jurisdiction — and reiterates federal preemption principles.").

[3] *In re PWS Holding Corp.*, 228 F.3d 224 (3d Cir. 2000).

[4] *In re S. Edge*, 478 B.R. 403.

[5] *In re Neogenix Oncology Inc.*, 508 B.R. 345, 362 (Bankr. D. Md. 2014).

[6] *In re Quincy Med. Ctr.*, 2011 WL 5592907 (Bankr. D. Mass. Nov. 16, 2011).

[7] *In re Connector 2000 Ass'n*, 447 B.R. 752, 761 (Bankr. D.S.C. 2011).

[8] *In re Yellowstone Mountain Club*, 460 B.R. 254, 266-67 (Bankr. D. Mont. 2011), *aff'd sub nom. Sumpter v. Yellowstone Mountain Club LLC*, 584 Fed. Appx. 676 (9th Cir. 2014).

[9] *In re Winn-Dixie Stores*, 356 B.R. 239, 260-61 (Bankr. M.D. Fla. 2006).

[10] *In re WCI Cable Inc.*, 282 B.R. 457, 479-80 (Bankr. D. Or. 2002).

[11] *In re Wash. Mut. Inc.*, 442 B.R. 314, 350-51 (Bankr. D. Del. 2011) (citations omitted).

[12] *See In re S. Edge*, 478 B.R. 403; *In re Yellowstone Mountain,* 460 B.R. 254; *In re Quincy Med. Ctr.,* 2011 WL 5592907; *In re Connector 2000*, 447 B.R. 752; *In re Winn-Dixie*, 356 B.R. 239.

[13] *In re Wash. Mut.*., 442 B.R. at 350-51 ("The exculpation clause must be limited to the fiduciaries who have served during the Chapter 11 proceeding: estate professionals, the committees and their members, and the debtors' directors and officers.").

[14] *In re PWS Holding*, 228 F.3d 224; *In re S. Edge*, 478 B.R. 403; *In re Neogenix*, 508 B.R. 345; *In re Wash. Mut.*, 442 B.R. 314; *In re Yellowstone Mountain*, 460 B.R. 254; *In re Winn-Dixie*, 356 B.R. 239; *In re WCI Cable*, 282 B.R. 457.

NEWS IN BRIEF

EVERYWARE GLOBAL FILES FOR CHAPTER 11 BANKRUPTCY PROTECTION

(Reuters) – EveryWare Global Inc., a marketer of cookware and tabletop products, filed for Chapter 11 bankruptcy protection April 7. The company listed assets of $100 million to $500 million and liabilities of $500 million to $1 billion in its petition in the Delaware bankruptcy court. Earlier in April, EveryWare said it expected to file for a prepackaged bankruptcy that would give its lenders control of the company after it emerges from bankruptcy within 60 to 75 days. The company said its secured lenders would own 96 percent of common stock and it would no longer trade publicly after emerging from bankruptcy. EveryWare, which was formed through the merger of Anchor Hocking LLC and Oneida Ltd. in March 2012, markets and distributes products such as bakeware, storageware and cookware in the United States, Canada, Mexico and Asia. (*Reporting by Rama Venkat Raman in Bengaluru; editing by Anupama Dwivedi*)

In re EveryWare Global Inc., No. 15-10743, voluntary Chapter 11 petition filed (Bankr. D. Del. Apr. 7, 2015).

BANKRUPTCY JUDGE TO APPROVE LIGHTSQUARED BANKRUPTCY EXIT PLAN

(Reuters) – A U.S. bankruptcy judge said March 26 she will approve wireless venture LightSquared's plan to exit bankruptcy and repay its largest creditor, Dish Network Corp. Chairman Charles Ergen, in full. An approval signals the end of nearly three years of litigation between LightSquared and Ergen, and paves the way for the company to exit Chapter 11 protection under the control of Centerbridge Partners and Fortress Investment Group. (*Reporting issued by Nick Brown; editing by Jeffrey Benkoe*)

In re LightSquared Inc., No. 12-12080, order confirming second amended joint plan issued (Bankr. S.D.N.Y. Mar. 27, 2015).

FEDERAL RESERVE OFFICIAL SEEKS TO PREVENT MUNICIPAL BANKRUPTCIES

An effort must be made to help municipalities address growing debt before bankruptcy becomes the only option, said New York Federal Reserve Bank President William Dudley, Reuters reported. Speaking at an April 14 workshop that addresses alternatives for distressed municipalities and states, Dudley said bankruptcies in Detroit and Stockton, Calif., may foreshadow more widespread problems. Dudley did not mention any municipalities by name but noted some have employed the worrisome practice of issuing debt to finance budget deficits and underfunding public pensions. The New York Fed president said borrowing to pay off deficits is "equivalent to asking future taxpayers to help finance today's public service."