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Toys “R” Us Bankruptcy Cases Highlight the Use of Third-Party Releases and “Opt-Out” Provisions in Chapter 11 Plans

The classic goal of a company that files for bankruptcy under Chapter 11 of the Bankruptcy Code is to restructure its finances and operations. Such restructuring efforts may culminate in a plan of reorganization, which is the functional equivalent of a new contract between the debtor entity and its creditors and other stakeholders. In evaluating a proposed plan, creditors will naturally focus on the treatment of their respective claims. Nonetheless, a plan may go well beyond setting out what and how creditors will be paid. In particular, it is common in complicated Chapter 11 cases for a plan to provide for the release of a creditor’s direct claims against certain non-debtor third-parties including a company’s current or former officers, directors, investors, affiliates, and subsidiaries.

Proposed releases under a plan may take a variety of forms. In particular, a proposed release may be consensual or non-consensual. A non-consensual release is essentially one where a creditor has no opportunity to “opt-out” of agreeing to the release when the creditor votes to accept or reject a plan of reorganization – if a plan receives sufficient affirmative votes and is subsequently confirmed by the Bankruptcy Court, the release becomes binding on the creditor. Because non-consensual releases are difficult to justify, or even barred outright in many jurisdictions, debtors often seek to obtain broader third-party releases by giving creditors an opportunity to express creditor consent to the releases when they vote to accept or reject a plan.

The various Chapter 11 plans in the recent Toys “R” Us cases pending in the Richmond, Virginia Bankruptcy Court illustrate the growing inclusion of “opt-out” provisions regarding proposed consensual releases in Chapter 11 plans. In the Toys “R” Us bankruptcy cases, Toys “R” Us and various affiliates and subsidiaries filed for protection under Chapter 11 after a disappointing 2017 holiday season. The companies subsequently filed plans of “reorganization” which, in fact, provided for the controlled liquidation of the companies (such plans of liquidation are themselves common under Chapter 11). Many of the Toys “R” Us plans have been confirmed by the Bankruptcy Court to include third-party releases. While there are numerous Chapter 11 plans involved in the Toys “R” Us bankruptcy, the various plans have a similar theme of including opt-out provisions regarding the third-party release clauses. Under an “opt-out” provision, a creditor or interest holder must affirmatively abstain from voting in favor of a Chapter 11 plan and provide documentation to the debtor stating that they do not consent to the release usually by checking a box on the voting ballot. Under these circumstances, a creditor agrees to any third-party release provided for in the Chapter 11 plan by failing to opt-out.

Creditors and parties with an interest at stake who are unaware of the third-party releases contained in a Chapter 11 plan may consent to the releases if they do not take any action. This places an affirmative duty on all creditors and affected parties to analyze a proposed Chapter 11 plan in order to protect their rights. Creditors included in a voting class are typically in a better position to opt-out because most voting ballots contain an opt-out option. However, any party with a

claim or interest that is not included in a voting class has to take further steps, such as file an objection with the Bankruptcy Court before a given objection deadline in order to effectively opt-out.

While third-party releases are expressly forbidden in some jurisdictions, most Bankruptcy Courts still allow them to some extent and the growing tendency is to impose an affirmative duty on creditors and interest holders to take action to opt-out of any third-party release. Experienced legal counsel can help you understand the issues affecting stakeholders faced with a third-party release contained in a proposed Chapter 11 plan and whether you should opt-out or take other action. Please contact the Hirschler Bankruptcy and Creditors' Rights Group for more information.

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