

Fourth Circuit Clarifies Position on Non-Debtor Releases

February 8, 2012 by [Andrew M. Greenberg](#) and [David E. Kronenberg](#)

On December 9, 2011, the U.S. Court of Appeals for the Fourth Circuit held that although non-debtor releases are permissible in certain contexts, the District Court for the Eastern District of Virginia erred in affirming a bankruptcy court's order approving the National Heritage Foundation's ("NHF") chapter 11 plan containing non-debtor releases. [Behrmann v. Nat'l Heritage Found., Inc.](#), 663 F.3d 704, 712-13 (4th Cir. 2011). The Fourth Circuit found that the bankruptcy court had not stated facts sufficient to justify its decision approving the debtor's plan. The Fourth Circuit refrained from adopting a particular test that must be satisfied before non-debtor releases may be approved, as other U.S. Circuit Courts of Appeal have done, instead emphasizing that Fourth Circuit bankruptcy courts should make such determinations on a case-by-case basis and explain such determinations with detailed facts. *Id.* Although [Behrmann](#) does not provide a test for determining whether particular non-debtor releases are permissible in the Fourth Circuit, the opinion provides some guidance as to the specificity necessary in bankruptcy court orders approving such provisions, and should be kept in mind by bankruptcy professionals preparing proposed findings of fact in support of chapter 11 plans.

Non-Debtor Releases Generally

Releases are commonplace in negotiated plans of reorganization, and are often required by various creditor and other constituencies as a condition to providing support for a plan. Although the primary function of bankruptcy plan releases is to release the debtor from liability associated with the bankruptcy case, a majority of courts extend such protection to third parties if certain unusual circumstances merit such relief. See [Airadigm Communications, Inc. v. FCC \(In re Airadigm Communications, Inc.\)](#), 519 F.3d 640, 656 (7th Cir. 2008), *reh'g denied*, 2008 U.S. App. LEXIS 11100 (7th Cir. May 13, 2008); [Deutsche Bank AG v. Metromedia Fiber Network, Inc. \(In re Metromedia Fiber Network, Inc.\)](#), 416 F.3d 136, 143 (2d Cir. 2005); [Class Five Nev. Claimants v. Dow Corning Corp. \(In re Dow Corning Corp.\)](#), 280 F.3d 648, 658 (6th Cir. 2002); [Gillman v. Continental Airlines \(In re Continental Airlines\)](#), 203 F.3d 203, 215 (3d Cir. 2000). These courts typically permit such releases pursuant to section 105(a) of the Bankruptcy Code, which provides bankruptcy courts with broad equitable powers to effectuate other provisions of the Bankruptcy Code. However, a minority of courts, such as the Ninth Circuit Court of Appeals in [Resorts International, Inc. v. Lowenschuss \(In re Lowenschuss\)](#), 67 F.3d 1394, 1401 (9th Cir. 1995), and the Tenth Circuit Court of Appeals in [In re Western Real Estate Fund, Inc.](#), 922 F.2d 592, 600 (10th Cir. 1990), hold that section 105, by itself, does not provide a basis for non-debtor releases. Further, these courts interpret section 524(e) of the Bankruptcy Code, which states in pertinent part that a "discharge of a debt of the debtor does not affect the liability of any other entity on, or in property of any other entity for, such debt", as expressly precluding the approval of non-debtor releases.

U.S. Circuit Courts of Appeal adopting the majority view generally agree that non-debtor releases should not be approved absent a finding of truly unusual circumstances, though they differ on the standards to apply in deciding such relief. See, e.g., [Metromedia](#), 416 F.3d at 142. ("No case has tolerated nondebtor [sic] releases absent the finding of circumstances that may be characterized as unique."). For example, the Sixth Circuit employs a seven factor test that examines, among other things, whether the party to be released has

contributed substantial assets to the reorganization, and whether the classes of parties to be enjoined have overwhelmingly accepted the plan. Dow Corning, 280 F.3d at 658. The Second Circuit requires a finding that a non-debtor release is an important part of the debtor's reorganization. Metromedia, 416 F.3d at 143. The Fourth Circuit, however, has not articulated a specific test for determining when the use of a non-debtor release is appropriate. In In re A.H. Robins Co., the leading case from the Fourth Circuit on non-debtor releases, the court reasoned that section 524(e) cannot act as a blanket prohibition on non-debtor releases because such releases are occasionally essential to a debtor's reorganization. 880 F.2d at 701-02. Rather than establishing a specific test that a bankruptcy court should use in determining the validity of a non-debtor release, in A.H. Robins the Fourth Circuit looked to the specific facts of the case, and approved a non-debtor release due to the overwhelming support for the debtor's plan, the fact that the plan gave a second chance for late claimants to recover, and the necessity of the release to the debtor's reorganization prospects. Id. at 702

Behrmann v. National Heritage Foundation, Inc.

In the instant case, NHF, a non-profit public charity, filed for chapter 11 protection in the U.S. Bankruptcy Court for the Eastern District of Virginia following the entry of an adverse state court judgment in excess of \$6 million. In its bankruptcy proceedings, NHF filed a proposed plan of reorganization that included release, injunction, and exculpation provisions preventing potential claimants from asserting claims against NHF, the official committee of unsecured creditors, any designated representatives of the committee, and any officers, directors, or employees of NHF, the committee, or their successors and assigns. Following the bankruptcy court's approval of NHF's plan of reorganization, certain parties in interest appealed the entry of the confirmation order to the U.S. District Court for the Eastern District of Virginia. The district court affirmed the bankruptcy court's approval of NHF's plan of reorganization, and the appellants further appealed the district court's decision to the Fourth Circuit.

In Behrmann, the Fourth Circuit reiterated its position that section 524(e) does not act as a prohibition on non-debtor releases, and further clarified that there is no specific test for approval of releases. Behrmann, 663 F.3d at 710, 712. The Fourth Circuit stated that a bankruptcy court considering the propriety of a non-debtor release "need not find a precise fit between the circumstances found in A.H. Robins and the case before it as a precondition to granting equitable relief." Id. at 711. Although certain specific tests used by other courts were instructive, the Fourth Circuit was satisfied to leave the determination of which factors may be relevant to the discretion of bankruptcy courts in the Fourth Circuit: "whether a court should lend its aid in equity to a Chapter 11 debtor will turn on the particular facts and circumstances of the case." Id. at 711. Nevertheless, the Fourth Circuit cautioned that approval of non-debtor releases should be granted cautiously and infrequently.

The Fourth Circuit ultimately vacated the district court's judgment. In so deciding, the Fourth Circuit did not take issue with the factors the bankruptcy court used to gauge the propriety of the releases, nor did it find the releases themselves to be inappropriate. Rather, it held that the bankruptcy court failed to provide a sufficiently detailed record supporting the issuance of such broad relief. Id. at 712-13. In approving NHF's plan of reorganization, the bankruptcy court vaguely stated that the release, injunction, and exculpation provisions: (1) were "essential" to the debtor's reorganization and appropriate given the debtor's "unique circumstances"; (2) were an "essential means" of implementing the confirmed plan; (3) were an "integral element" of the transactions contemplated in the confirmed plan; (4) conferred a "material benefit" on the debtor, its bankruptcy estate and its creditors; (5) were "important" to the plan's overall objectives; and (6) were "consistent" with applicable provisions of the Bankruptcy Code. Id. The Fourth Circuit found that such findings were rendered

meaningless in the absence of factual support. Accordingly, it vacated the district court's judgment and remanded the case to the bankruptcy court to make the necessary factual findings, if appropriate.

Conclusion

Behrmann reiterated that in the Fourth Circuit there is no precise test for determining whether non-debtor releases are permissible, and clarified that Fourth Circuit bankruptcy courts have discretion to determine which factors should be considered in approving releases, on a case-by-case basis. Despite the wide discretion accorded to Fourth Circuit bankruptcy courts on this issue, the Fourth Circuit clearly will not allow such relief to be granted absent a detailed evidentiary showing in support of the need for non-debtor releases. It remains to be seen exactly what degree of detail will be necessary to support a finding that non-debtor releases are permissible in the Fourth Circuit, and whether courts in other circuits will require similar evidentiary showings.