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A Third Party Release in a Confirmed Plan Shields Against Unknown and Nonexistent Claims

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February 22, 2016 - Bankruptcy law and business expectations converged in the Residential Capital (“ResCap”) proceeding when the Bankruptcy Court confirmed that the third party release contained in ResCap’s plan of reorganization protected ResCap’s non-debtor parent from claims that were not known and did not exist at the time the plan was confirmed. The Bankruptcy Court reasoned that Section 502(h) of the Bankruptcy Code permitted the third party release to shield the parent even though the claim was contingent on the outcome of an adversary proceeding filed after the plan’s confirmation. This aligned with the business expectation of the plan’s financial sponsor, Ally Financial Inc. (“AFI”), the non-debtor parent that had contributed \$2.1 billion to the reorganizing debtor to facilitate confirmation.

ResCap’s plan permanently releases and enjoins “holders of Claims” from pursuing claims against AFI that arose from or related in any way to the debtors (the “Third Party Release”). Subsequent to confirmation, the ResCap Litigation Trust filed an adversary proceeding against pre-petition service providers to the debtors (the “Service Providers”) to recover \$800,000 that had been transferred to them. The Service Providers answered and included a third party complaint against AFI seeking recoveries from AFI to the extent of ResCap’s success in the adversary proceeding. AFI moved to dismiss the third party complaint.

The Bankruptcy Court agreed with AFI and dismissed the complaint against AFI to the extent the Service Providers’ services had been rendered to the debtors.[1] The Court reached its conclusion parsing the Third Party Release language and the definition of a claim in Bankruptcy, particularly a claim arising under Section 502(h), which the parties agreed would be the basis for the Service Providers’ claim. First, the Bankruptcy Court reasoned that the Third Party Release language was clear and unambiguous in its scope. The confirmed plan’s litany of adjectives both describing the released claims in the Third Party Release and also defining a “cause of action” served their purpose: the Service Providers’ claim against AFI – one that was certainly contingent and was not even known or anticipated at the plan’s confirmation – was barred by the Third Party Release. Second, the Bankruptcy Court used the special characteristics of claims arising under Section 502(h) of the Bankruptcy Code to support its reading

that the Service Providers' cause of action was covered by the Third Party Release. Reasoning that because 502(h) provides that its claims arise "as if such claim had arisen before the date of the filing of the petition," the Bankruptcy Court concluded that sweeping the claim under the Third Party Release was consistent with the Bankruptcy Code's definition of a claim even though the claim had not existed at the plan's confirmation.

This ResCap decision should provide further comfort to parties contributing funds towards a plan's confirmation: the third party release will protect them from future lawsuits. But beneficiaries of these third party releases should be careful that the language is clear and broad and covers the claims from which it wants to be released. Even in this well-reasoned opinion, the Bankruptcy Court declined to dismiss the complaint to the extent it might have been a cause of action that did not relate to the debtor, a condition of the ResCap Third Party Release. This decision is also one that will encourage attorneys to continue to include the litany of adjectives describing potential claims that often cause drafters' and readers' eyes to glaze over. But here, the Bankruptcy Court found comfort in these adjectives' abundance to conclude that the Third Party Release was intended to reach even unknown and nonexistent claims.

Footnotes

[1]. The Bankruptcy Court found that a fact issue existed with respect to a portion of the claim because the services may have been rendered directly to AFI, and that portion of the third party complaint was not dismissed.

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