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In Defense of Consensual, Opt-Out Third-Party Releases from a Delaware Perspective

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In *Purdue*, a majority of the U.S. Supreme Court concluded that the Bankruptcy Code does not authorize nonconsensual releases of claims against nondebtors.[1] However, both the majority and the dissent endorsed *consensual* releases of third-party claims.[2] Courts have long permitted consensual third-party releases.[3] Left unanswered is what constitutes "consent,"[4] a question that has long pre-dated *Purdue*.[5]

A minority of courts have taken the position that a claimant must opt in, or take an affirmative step to show assent, to be deemed to have consented, while the majority have held that a claimant's failure to opt out constitutes deemed consent. Highlighting Delaware bankruptcy jurisprudence that reflects that split, this article advocates for the majority view that favors opt-out releases and deemed consent where fair and appropriate based on the circumstances.[6] The recent *Smallhold* decision indicates that opt-out releases continue to be permissible but under a narrower set of circumstances post-*Purdue*.[7]

Delaware Jurisprudence Illustrates the Nonconsensus on Consent

The split on whether consent can be deemed based on silence and inaction or requires an affirmative act of assent is evident among the Delaware bankruptcy bench, where the majority view has permitted opt-out releases as long as adequate notice was provided. The minority view was adopted by Hon. **Mary F. Walrath** in *Washington Mutual*, where the plan purported to allow voting parties to opt out of granting a release by checking a box on the ballot.[8]

Judge Walrath concluded that the opt-out mechanism was insufficient, especially for those who did not or could not vote, because "[f]ailing to return a ballot is not a sufficient manifestation of consent to a third-party release."[9] Instead, the third-party release would be effective only against those who affirmatively consented by voting in favor of the plan and did not opt out of the release.[10] Judge Walrath's view may have evolved, as she has approved plans containing opt-out releases in recent years.[11]

Hon. **Karen B. Owens** followed the minority view in *Emerge Energy*, agreeing with the objections of the U.S. Trustee and others, and declining to approve third-party releases based on inferred consent by failure to return a ballot or opt-out form.[12] Although the court indicated that the ballots and opt-out forms sent to creditors and interest-holders included conspicuous notice of the opt-out process and the consequences of not opting out, it followed *Washington Mutual* and other cases in concluding that failure to return an opt-out could not be "said with certainty" to be intentional.[13] Noting disagreement with her col-

1 *Harrington v. Purdue Pharma LP*, 603 U.S. __, 219 L. Ed. 2d 721, 2024 U.S. LEXIS 2848 (2024). The one exception is that 11 U.S.C. § 524(g) permits nonconsensual third-party releases in plans addressing asbestos liabilities.

2 2024 U.S. LEXIS 2848, *31-32 ("Nothing in what we have said should be construed to call into question *consensual* third-party releases offered in connection with a bankruptcy reorganization plan; those sorts of releases pose different questions and may rest on different legal grounds than the nonconsensual release at issue here."); *id.* at *86 (dissent noting that "it is 'well-settled that a bankruptcy court may approve' such consensual releases").

3 *Id.* at *85-86 ("Consensual nondebtor releases are routinely included in bankruptcy plans even though those releases apply to claims by victims or creditors against nondebtors."); *see also, e.g., In re Retail Grp. Inc.*, No. 20-33133-KRH, 2021 Bankr. LEXIS 547, *80 (Bankr. E.D. Va. March 9, 2021) ("Most courts allow consensual nondebtor releases to be included in a plan."); *In re Neogenix Oncology Inc.*, 508 B.R. 345, 361 (Bankr. D. Md. 2014) ("The rationale for allowing consensual third-party releases is that the affected parties are bound by their consensual agreement.").

4 2024 U.S. LEXIS 2848, *32 ("Nor do we have occasion today to express a view on what qualifies as a consensual release or pass upon a plan that provides for the full satisfaction of claims against a third-party nondebtor.").

5 8 *Collier on Bankruptcy* ¶ 1141.02[5][b] ("There is no clear, controlling standard [as to what constitutes adequate manifestation of consent] as there continues to be a lack of Circuit-level case law on the subject.").

6 Our view agrees with *In re Robertshaw US Holding Corp.*, No. 24-90052, 2024 Bankr. LEXIS 1958 (Bankr. S.D. Tex. Aug. 16, 2024), which issued from a circuit that prohibited nonconsensual third-party releases prior to *Purdue*. In *Robertshaw*, Hon. **Christopher M. Lopez** found that consensual releases were consistent with due process as "what constitutes consent, including opt-out features and deemed consent for not opting out," had been long accepted and approved in hundreds of chapter 11 cases in the Southern District of Texas. *Id.* at *52. On different facts, Hon. **Carl L. Bucki** upheld objection to a disclosure statement for a plan with a third-party release, finding that "the mere ability to opt out of a release is insufficient" for consent under state contract law. *In re Tonawanda Coke Corp.*, BK 18-12156-CLB, 2024 Bankr. LEXIS 2032, *6-7 (Bankr. W.D.N.Y. Aug. 27, 2024).

7 *In re Smallhold Inc.*, No. 24-10267(CTG), 2024 Bankr. LEXIS 2332 (Bankr. D. Del. Sept. 25, 2024).

8 *In re Washington Mut. Inc.*, 442 B.R. 314, 351 (Bankr. D. Del. 2011).

9 *Id.* at 355.

10 *Id.* The court found no issue with the plan conditioning distribution on the granting of a third-party release because 11 U.S.C. § 1123(a)(4) permits different treatment to a creditor who agrees to settle instead of pursuing litigation, as long as each claimant within a class had the same opportunity for equal treatment. *Id.* at 355-56.

11 *See In re Clarus Therapeutics Holdings Inc.*, No. 22-10845 (MFW) (Bankr. D. Del. Feb. 9, 2023), Doc. 320, confirmation order at ¶ CC; *In re EYP Grp. Holdings Inc.*, No. 22-10367 (Bankr. D. Del. Nov. 1, 2022), Doc. 568, confirmation order at ¶ T.

12 *In re Emerge Energy Servs. LP*, No. 19-11563 (KBO), 2019 Bankr. LEXIS 3717, *53 (Bankr. D. Del. Dec. 5, 2019).

13 *Id.* at *53 (also citing *In re Chassix Holdings*, 533 B.R. 64 (Bankr. S.D.N.Y. 2015); *In re Sun Edison Inc.*, 576 B.R. 453 (Bankr. S.D.N.Y. 2017)).

leagues, Judge Owens held that a "waiver cannot be discerned through a party's silence or inaction unless specific circumstances are present [because a] party's receipt of a notice imposing an artificial opt-out requirement, the recipient's possible understanding of the meaning and ramifications of such notice, and the recipient's failure to opt out simply do not qualify."[14]

Following the majority view, Hon. **Brendan Linehan Shannon** overruled the U.S. Trustee's objection in *Indianapolis Downs*, noting that Delaware bankruptcy courts "have consistently held that a plan may provide for a release of third-party claims against a nondebtor upon consent of the party affected."[15] The U.S. Trustee argued that *Washington Mutual* required affirmative consent to render a third-party release enforceable, but Judge Shannon found that "no such hard-and-fast rule applies," and courts within and outside of Delaware have "taken a more flexible approach ... finding that even impaired creditors who abstained from voting on a plan and did not otherwise opt out were nonetheless bound."[16] Judge Shannon found the release to be consensual because it applied to unimpaired creditors who were deemed to have accepted the plan and would receive payment in full for the release; the impaired creditors who abstained from voting on the plan or voted to reject it, but did not opt out of the release, were likewise bound because they had been provided detailed information and had the opportunity to opt out on their ballots.[17]

Nearly a decade later, Hon. **John T. Dorsey** noted the split within Delaware when he overruled the U.S. Trustee's objection to an opt-out release by non-opioid claimants in *Mallinckrodt*.[18] While the opinion also addressed nonconsensual releases struck down by *Purdue*, it noted various contexts of the judicial system in which consent can be deemed based on a person's failure to act, such as entry of default judgment for failure to respond to a complaint or motion, and the barring of bankruptcy claims for which a proof of claim or response to objection is not timely filed.[19] Judge Dorsey noted that Hon. **Christopher S. Sontchi** (now retired) had concluded that opt-out releases are consensual not under contract law, but as a matter of notice under the Bankruptcy Code and Federal Rules of Bankruptcy Procedure.[20]

Mallinckrodt also highlighted the importance of notice in upholding opt-out releases, finding that releasing parties were sufficiently aware of the need to act where they "were sent notices in a variety of ways that explained in no uncertain terms that action was required to preserve claims."[21] Agreeing with Hon. **Kevin Gross** (now retired), who had likewise concluded in another opioid-related mass tort bankruptcy, Judge Dorsey observed that the *Mallinckrodt* case was "very well-known ... with a very active body of creditors and stakeholders," an extensive docket and litigation history, and the subject of press coverage due to the significant public interest of the issues involved.[22] Noting that his colleagues in *Washington Mutual* and *Emerge Energy* questioned whether consensual releases through an opt-out process may ever be appropriate, Judge Dorsey distinguished those holdings as not involving mass tort bankruptcies — the context that the Third Circuit suggested might be appropriate for such releases because such cases tend to require creative solutions and flexibility.[23]

Addressing the U.S. Trustee's objection in the *Boy Scouts* case, Hon. **Laurie Selber Silverstein** agreed with Judge Dorsey's approach in *Mallinckrodt* that sufficient notice was a significant factor in approving a release based on opt-out consent.[24] The court determined the opt-out releases were appropriate because the terms of the opt-out process and language of the release were prominently displayed (in bold, all caps and surrounded by a box) on each ballot, notice was also published in national newspapers, a significant percentage of voters chose to opt out, and persons who were not provided adequate notice would be able to later raise their claims.[25]

Hon. **Craig Goldblatt** reiterated the majority view in *Arsenal*, noting that "in the typical case, so long as the disclosure is prominent and conspicuous, and impaired creditors are given the ability to opt out simply by marking their ballot or by some other comparable device, it is appropriate to infer consent from a creditor's failure to opt out," and that "[r]eleases contained in a plan that permit creditors to opt out may be deemed consensual as to those who do not exercise that option."[26] Aware that Judge Goldblatt subscribed to the majority view, the U.S. Trustee focused its objection on the unusual circumstances of the case that purportedly required an opt-in procedure.[27] The court agreed that the case was atypical and warranted additional protection because one of the court's orders had the unintended consequence of potentially inhibiting creditors from learning of their claims.[28]

As Judge Goldblat explained, whether circumstances require additional protection is "more a matter of art than of science," and that it is a matter of discretion rather than a pure question of law such that "the fact that different judges have reached somewhat different judgments should be seen as neither surprising nor problematic."[29] He noted that some courts base the issue of whether a release is consensual on contract law, which generally requires affirmative assent.[30] Other courts hold that nonconsensual third-party releases should be evaluated for appropriateness on a case-by-case basis like any other plan provision.[31]

14 *Id.* at *55.
15 *In re Indianapolis Downs LLC*, 486 B.R. 286, 305 (Bankr. D. Del. 2013).
16 *Id.*
17 *Id.* at 306.
18 *In re Mallinckrodt PLC*, 639 B.R. 837 (Bankr. D. Del. 2022).
19 *Id.* at 879.
20 *Id.* at 879-80 (quoting *Extraction Oil & Gas Inc.* (Bankr. D. Del. Dec. 23, 2020), Confirmation Hr'g Tr. at 80-81).
21 *Id.* at 880.
22 *Id.* at 880-81 (citing *In re Insys Therapeutics Inc.*, No. 19-11292 (KG) (Bankr. D. Del. Jan. 16, 2020), Confirmation Hr'g Tr.).
23 *Id.* at 881 (citing *In re Cont'l Airlines*, 203 F.3d 203 (3d Cir. 2000)).
24 *In re Boy Scouts of Am. and Delaware BSA LLC*, 642 B.R. 504, 675 (Bankr. D. Del. 2022).
25 *Id.* at 678.
26 *In re Arsenal Intermediate Holdings LLC*, No. 23-10097 (CTG), 2023 Bankr. LEXIS 752, *2 (Bankr. D. Del. March 27, 2023).
27 *Id.* at *7.
28 *Id.* at *29-30.
29 *Id.* at *4.
30 *Id.* at *10-11 (citing *In re Sun Edison Inc.*, 576 B.R. 453 (Bankr. S.D.N.Y. 2017); *Washington Mut.*, 442 B.R. 314).
31 *Id.* at *11-12 (citing *Cont'l Airlines*, 203 F.3d at 217).

continued on page 62

from page 13

Because the bankruptcy process is adversarial in nature, to be "consensual" a third-party release does not require the unanimous approval of those creditors that will be bound by it.[32] Instead, "forfeited" might be a more accurate term, and it might be that affected parties were "careless, inattentive, or mistaken," but as long as they received notice and an opportunity be heard and no one exercised the right to object, the release is considered "consensual."[33]

However, in *Smallhold*, Judge Goldblatt concluded that *Arsenal* does not survive *Purdue*.[34] *Arsenal* was decided when a nonconsensual release could be approved as part of a reorganization plan, which meant that an objecting creditor had a duty to speak or be bound to it.[35] Because *Purdue* invalidated the use of nonconsensual third-party releases, a release is no longer like any other contestable plan provision to which a nonobjecting creditor can be held as a matter of default.[36]

Limiting his decision to the *Smallhold* facts, Judge Goldblatt upheld the use of an opt-out for creditors who were entitled to and affirmatively voted on the plan, but did not elect the opt-out box on the ballot.[37] The court was satisfied that "the affirmative act of voting, coupled with clear and conspicuous disclosure and instructions about the consequences of the vote and a simple mechanism for opting out, is a sufficient expression of consent to bind the creditor to the release under ordinary contract principles."[38] However, the court concluded that creditors who were to be paid in full, and thereby deemed to have accepted the plan and not provided a ballot or opt-out form, could not be bound to a release, notwithstanding strong policy reasons (such as finality) or that *Purdue* expressly left open whether a paid-in-full creditor could be so bound.[39]

Conclusion

Delaware precedent before and after *Purdue* demonstrates that there is no hard-and-fast rule on the appropriateness of opt-out releases.[40] A case-by-case analysis is warranted to determine whether deemed consent is fair and appropriate. Adequate notice is a significant factor, which might necessitate conspicuous display of release terms, the need to act and the consequences of failing to act. Absent case-specific circumstances that raise fairness questions, an opt-out release should remain as an option. abi

Editor's Note: *ABI held a webinar shortly after the Supreme Court issued its decision in this case. To listen to the abiLIVE recording, please visit abi.org/newsroom/videos. ABI also published a digital book,* The Purdue Papers*, a compilation of 3,500+ pages of amicus briefs, petitions and other related background material. To order your downloadable copy, visit store.abi.org.*

32 *Id.* at *17.
33 *Id.* at *18.
34 2024 Bankr. LEXIS 2332, *23.
35 *Id.* at *29.
36 *Id.* at *31.
37 *Id.* at *40-42. Notably, the debtor indicated that it would not bound to releases those creditors who did not return a ballot. *Id.* at *16-17.
38 *Id.* at *8.
39 *Id.* at *38-40.
40 The authors did not locate any published decisions addressing opt-out releases by Hon. **J. Kate Stickles** and Hon. **Thomas M. Horan**, who joined the Delaware bankruptcy bench in 2021 and 2022, respectively.