Part V

Group-sensitive Insolvency Law: Tools and Solutions

10 Group Debt Deleveraging and Debt Adjustment: Third-party Releases■

10.1 Introduction

This part explores various "tools and solutions" for the specific concerns or problems discussed in the preceding part of the book. This is not to say that the legal instruments (e.g. transaction avoidance, statutory subordination of intra-group claims), transactions (e.g. cross-guarantees, intra-group loans), or contractual clauses (e.g. cross-entity ipso facto and cross-default clauses) are problems themselves. In fact, they often pursue legitimate goals, and are value-creating and beneficial. For example, as noted in Chapter 8, transaction avoidance rules serve an important purpose of maximising estate value and ensuring equal treatment of creditors. When viewed from this perspective, transaction avoidance itself becomes a solution to the problem of fraudulent and undervalued transactions, and unfair preferences. Similarly, typical group-related transactions, such as cross-guarantees and intra-group loans, may contribute to the efficient attraction and allocation of funds within an enterprise group, thereby facilitating the creation of value. Yet, as mentioned before, the explored legal instruments, transactions, and contractual clauses can create or exacerbate "problems" in a group insolvency context.

For instance, Chapter 8 discussed the problematic application of transaction avoidance law to transactions involving group entities. It was observed that frequently transactions, like group guarantees, are driven by group considerations or group interest. As a consequence, there may be no direct benefit for a group entity providing a guarantee. In view of legal separateness, recognising indirect benefits and determining the true economic effect a cross-guarantee could be challenging and might result in legal uncertainty. But let's assume that this transaction withstands legal scrutiny and is considered valid and enforceable – meaning it is not void *ab initio* and is not nullified upon the successful invocation of avoidance rules. In

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■ This chapter builds upon the following previously published work by the author:
- I. Kokorin, S. Madaus and I. Mevorach, Global Competition in Cross-Border Restructuring and Recognition of Centralized Group Solutions, Texas International Law Journal, Vol. 56, 2021, pp. 109-154.
- I. Kokorin, The Rise of "Group Solution" in Insolvency Law and Bank Resolution, European Business Organization Law Review, Vol. 22, 2021, pp. 781-811.
- I. Kokorin, Third-Party Releases in Insolvency of Multinational Enterprise Groups, European Company and Financial Law Review, Vol. 18, 2021, pp. 107-140.

such a case, the group guarantee is likely to affect the dynamics of group insolvency and restructuring. The exact ways in which this could happen were outlined in Chapter 6, dealing with various ex ante and ex post effects of cross-guarantees.

This chapter covers the response to the insolvency-related (ex post) effects produced by cross-guarantees and similar cross-entity liability arrangements. Given the group interconnectedness and synergies, as well as the complexities created by the triangle of rights and liabilities (principal debtor – creditor – group guarantor), more and more jurisdictions are adopting rules that provide for the possibility to restructure obligations of third parties, like group guarantors, through a single proceeding opened with respect to one group entity ("anchor" debtor[1]). Such restructuring is made possible via so called "third-party releases". In this chapter, we analyse this novel legal instrument or tool, which can be used to deleverage or adjust the debt of several group entities.[2]

This chapter proceeds as follows. Section 10.2.1. studies the rationale of third-party releases. It is followed by a comparative analysis, examining the availability of and conditions for third-party releases in three core jurisdictions: the UK (section 10.2.2.), the USA (section 10.2.3.) and the Netherlands (section 10.2.4.). This analysis reveals that the countries, and even courts within the same country (e.g. USA), adopt divergent views on the availability and desirability of third-party releases, not least because of their substantial effects on creditors' rights in the absence of certain bankruptcy law safeguards. Section 10.3. concludes with a summary of the main findings and a proposal of elements or considerations that may guide the design and application of rules on third-party releases.

10.2 Third-Party Releases

10.2.1 Rationale of third-party releases

As follows from Chapter 6, most commonly, insolvency of the principal debtor does not affect the rights of creditors against group guarantors, co-debtors and collateral providers. If it were, the protective function of these contractual arrangements would be undermined.

1 The term "anchor debtor" is borrowed from G. Ray Warner and M. Veder, Enterprise Group Restructuring: Dutch Options and United States Enforcement, European Insolvency and Restructuring Journal, 2021-7, 2021, pp. 1-52.

2 Different considerations might apply to third-party releases outside the enterprise group context. These non-group instances include, inter alia, releases of insurance companies, directors, legal and financial advisors, and tortfeasors in mass tort litigation. These cases often raise distinct legal and moral questions and touch upon different policy reasons. Therefore, they fall outside the scope of this book.

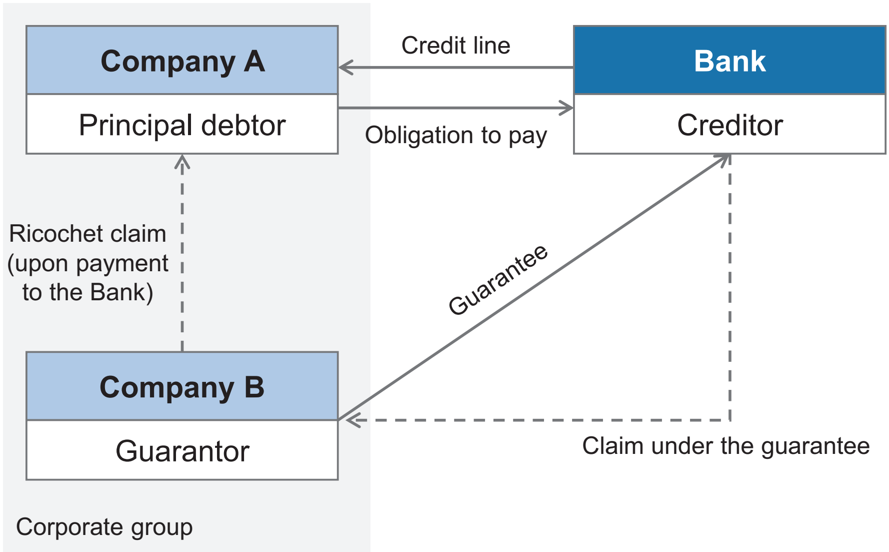

Figure 10. Triangle of rights and liabilities in group financing

Imagine that Company A initiates insolvency or restructuring proceedings, in which the claim of the Bank is altered. The fact that a claim of the Bank against the principal debtor (Company A) has been reduced or completely written down in a non-consensual way shall generally not affect the Bank's rights under the guarantee.[3] Yet this is not the end of our consideration.

In integrated groups, where the fates of group entities are intertwined or closely tied together, successful restructuring of a group entity often requires the preservation of group synergies and the survival of other group members. A debtor may need their assistance to both implement the reorganisation plan and to continue its operational activity in the wake of restructuring. The American Bankruptcy Institute recognised that such assistance could take the form of "service, collaboration, funding, business commitments, or other means that allow the debtor to achieve its objectives in the chapter 11 case or in its postconfirmation operations."[4] Be it as it may,

3 A situation is different if the creditor voluntarily discharges the principal debtor of its liability (workout). In this case, because of the accessory nature of a guarantee or suretyship, the corresponding liability of a guarantor could be discharged or reduced accordingly. See section 6.5.2.

4 ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations (ABI Commission), 2014, p. 255.

third parties acting as guarantors, co-debtors and collateral providers[5] can be reluctant to contribute to the restructuring plan or extend assistance thereafter if they remain exposed to creditor claims and are liable despite the confirmation of the debtor's restructuring plan. They might also be forced into insolvent liquidation or end up being sold to a competitor. This can have a significant effect on the economic viability of the anchor debtor. This debtor may end up failing in the future – a situation referred to as the "orphan restructuring problem". Therefore, a single-entity-focused restructuring without due consideration of the group reality, position and interests of group members risks being short-lived and inefficient.

Of course, a guarantor can initiate its own proceeding. However, this creates coordination and other transaction costs, especially if parallel proceedings are opened in different countries. Oi Brazil is a perfect demonstration of this (section 1.1.3.). The multiplication of proceedings is a cumbersome, costly and time-consuming solution. In addition to the redundancy of multiple proceedings, Veder and Thery argue that the duplication of proceedings gives an additional opportunity to dissenting creditors to exercise their holdout leverage, "if only it were for the litigation risk, costs and timing associated with the remedies available in the second proceedings."[6] Coordinated distress resolution within an enterprise group, especially where the group is international, is promoted by procedural centralisation. Such centralisation entails the concentration of separate insolvency proceedings in a single forum or in one court. It also manifests itself in situations where obligations of several group entities are restructured in a single proceeding opened with respect to one of them.

Over recent decades, restructuring liability within enterprise groups has increasingly been implemented via plans that approve third-party releases, allowing the resolution of claims against the principal debtor and its affiliates acting as guarantors, co-debtors, and collateral providers. In essence, a third-party release extends the legal effect of debt restructuring and responds to the complexities of group financing by sanctioning a single group-wide solution. Historically, third-party releases have been available

5 In the US literature and case law, such third parties are referred to as "nondebtors". See e.g. ABI Commission, p. 253. This term may be confusing since these parties owe the creditor and are, in a sense, debtors, although not always the principal ones (e.g. surety). Nevertheless, the term "nondebtor" can still be useful to signal that such a person is not subject to an insolvency or restructuring proceeding of its own.

6 M. Veder, A. Thery, The release of third party guarantees in pre-insolvency restructuring plans, in D. Faber, B. Schuijling and N. Vermunt (eds), Trust and Good Faith across Borders, Liber Amicorum Prof. Dr. S.C.J.J. Kortmann, Wolters Kluwer, 2017.

in common law jurisdictions, such as Australia,[7] Canada,[8] Singapore,[9] Ireland,[10] the Cayman Islands[11] and the UK. More recently, however, the tool of third-party releases was incorporated in civil law jurisdictions, including the Netherlands and Germany.

10.2.2 The UK: third-party releases in schemes of arrangement

English schemes of arrangement require some "give and take" on each side, as opposed to mere surrender or forfeiture.[12] The question is whether this "give and take" and the underlying arrangement are only available to the principal debtor and its creditors or can also extend to third parties. In *Re T&N Ltd.* the court ruled for the latter.[13] The case was decided under the Companies Act 1985 (sec. 425) and concerned actual and potential claims of employees and former employees of T&N Limited and 57 associated companies (debtors) for damages due to personal injuries from exposure to asbestos. Under the scheme, the debtors and employees (claimants) agreed not to assert their claims against liability insurers, on the condition that the insurers would establish a fund of £36.74 million to be held in trust to pay the damages whenever they are established. It was objected that the proposed scheme did not constitute an arrangement between T&N Limited and its creditors but instead represented a compromise between the debtors and insurers since the scheme did not compromise the rights of claimants against the scheme companies. The court dismissed this objection and affirmed the scheme. It held that the term "arrangement" had a broad meaning, which encompassed a settlement of litigation between T&N Limited and insurers to the extent that the settlement ("not immediately") affected the position of the debtors and was effectively a "tripartite matter". According to the court, the scheme was "an integral part of a single proposal affecting all the parties."[14]

This wide interpretation of the scope of schemes of arrangement was affirmed in *Re Lehman Brothers International (Europe)*, where the court noted that it was "entirely logical" to extend the jurisdiction to approve a scheme that varies or releases creditors' claims against both the principal debtor

7 *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; *Re Tiger Resources Ltd.* [2019] FCA 2186.

8 *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587 (Ont. C.A.).

9 *Pathfinder Strategic Credit LP v. Empire Capital Resources PTE Ltd.* [2019] SGCA 29.

10 *In the matter of Nordic Aviation Capital Designated Activity Company* [2020] No. 162 COS.

11 *Re Sphinx Group of Companies*, Grand Court of the Cayman Islands, unreported, 5 May 2010.

12 *Re NFU Development Trust Ltd* [1972] 1 WLR 1548; *Re Lehman Brothers International (Europe) (in admin.)* [2018] EWHC 1980 (Ch); [2019] B.C.C. 115, at 64.

13 *Re T&N Ltd. (No. 3)* [2006] EWHC 1447 (Ch).

14 Ibid., at 52.

and third parties "designed to recover the same loss."[15] Claims subject to a release can be contractual or tortious in nature, as in the T&N case, and can be secured or unsecured. Importantly, the English court ruled that the release of a third party should be ancillary to the arrangement between the principal debtor and its own creditors, and that such a release must be "necessary in order to give effect" to the arrangement. This "necessity" requirement has come to be referred to as the "*Lehman* necessity".[16] Another qualification added by the court was that the rights of creditors against third parties should be closely connected with their rights against the principal debtor. On this point, the court highlighted that "the decision in T&N Ltd (No. 3) [was] near the outer limits of the scope of s. 895."[17]

A more recent case, *Far East Capital Limited*,[18] involved a discharge of obligations under two sets of notes in return for a payment by the debtor of a settlement amount. The scheme included the release of third parties – group entities that provided guarantees and security for the notes. Additionally, the release was given to other identified "protected parties" who had been involved in the preparation, negotiation, or implementation of the scheme. In *Van Gansewinkel Groep BV and others*, the court held that a release should be "necessary to give legal or commercial effect to the compromise or arrangement between the scheme company and its creditors."[19] The case concerned the release of group members under guarantees. In *La Seda De Barcelona*,[20] the court sanctioned a scheme that provided for the release of a third-party – group member Artenius under the guarantee agreement, in exchange for Artenius releasing other group members of its own claims. Thus, the release of Artenius benefited the scheme creditors because its release of the debtor and other group companies improved their financial position. In the alternative scenario, Artenius' claims could have triggered "insolvency of a company which would have escalated group bankruptcy proceedings."[21]

In *Noble Group Limited*,[22] the scheme was part of a complex group restructuring where, in return for writing off creditors' claims, the creditors received debt instruments issued by the newly incorporated companies. Additionally, the scheme entailed the release of claims against the debtor's man-

15 *Lehman Brothers International (Europe), Re Insolvency Act 1986* [2009] EWCA Civ 1161, at 63.

16 *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch), at 163, noting that "[w]here the alteration of creditors' rights against third parties is both ancillary to the arrangement between the company and its creditors and necessary to ensure the effectiveness of that arrangement, then they will be permitted."

17 *Lehman Brothers International (Europe), Re Insolvency Act 1986* [2009] EWCA Civ 1161, at 83.

18 *In the matter of Far East Capital Limited S.A.* [2017] EWHC 2878 (Ch).

19 *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch).

20 *In Re La Seda de Barcelona SA* [2010] EWHC 1364 (Ch).

21 Ibid., at 19.

22 *In the Matter of Noble Group Limited* [2018] EWHC 3092 (Ch).

agement, a group of its senior creditors, their related parties and officers, directors, employees, agents, advisors, and representatives. It encompassed claims relating to the scheme claims and the preparation, negotiation, sanctioning or implementation of the scheme. The court acknowledged the breadth of the suggested release to include any claims arising from or related to the scheme claims. This, however, was not found to be problematic. When sanctioning the scheme with a third-party release, it mentioned that an issue could arise where a scheme creditor has a more "tangential" claim against the to-be-released third party (e.g. a claim by a creditor in negligence against an independent financial adviser who advised that creditor to purchase financial instruments). The court noted that this could affect class composition, because only some, but not all, scheme creditors would be entitled to pursue such a claim.

In sum, English schemes of arrangement are flexible and commercially driven when it comes to third-party releases. It is well established that in certain circumstances, a scheme can, as part of the arrangement between the scheme company (the "anchor" debtor) and a creditor, require the creditor to give up or vary its rights against a third party, a person other than the scheme company. Claims arising from various types of intercompany liability arrangements (guarantees, co-debtorship, third-party collateral), facilitating group interconnectedness and interdependence, will commonly be eligible for a release. This is because such a release may be seen as necessary to give effect to the proposed arrangement. Without it, the guaranteed creditor is entitled to sue the guarantor, and the guarantor is then entitled to claim the entire amount from the principal debtor (i.e. a scheme company) in accordance with the guarantor's right to an indemnity (section 6.5.3.1.). This indemnity claim can defeat the purpose of the whole scheme, as the principal debtor would ultimately remain liable for the very amount that was purportedly compromised by the scheme.

The mechanism frequently adopted to achieve a release of group guarantors is through a clause in the scheme that confers authority upon a nominated person to execute a deed of release or variation on behalf of the scheme creditors in favour of third parties.[23] The release can be granted where the "anchor debtor" is a principal debtor,[24] where it is one of the principal

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23 *Re Noble Group Ltd (sanction)* [2019] 2 BCLC 548, at 24; *Re Van Gansewinkel Groep BV* [2015] Bus LR 1046, at 16.

24 *Re APCOA Parking Holdings GmbH* [2014] EWHC 3849 (Ch), 2014 WL 5833966; *In the Matter of Noble Group Limited* [2018] EWHC 3092 (Ch).

debtors,[25] or where it is a guarantor.[26] Three aspects are worth emphasising concerning third-party releases under English law.

First, a wide range of "third parties" may benefit from a release. These parties can include both related parties (e.g. group entities, their directors and officers) and non-affiliated parties (e.g. insurers, auditors, legal and financial advisors).[27] Second, claims subject to a release can be contractual (e.g. based on a guarantee, co-debtorship or collateral arrangement) or non-contractual (e.g. arising in tort), secured or unsecured. Third, there are certain requirements imposed on third-party releases. Payne distinguishes four of them:[28]

- A scheme should involve a genuine "give and take". This does not necessarily entail equal monetary consideration and could include indirect benefits in the short or long run (e.g. financial stability of the group as a whole). English courts do not always closely scrutinise this requirement.[29]
- Creditors' rights against a third party must be sufficiently closely connected with the claims against the principal debtor. This includes claims under guarantees, co-debtorship and collateral arrangements, but may also encompass other claims that potentially affect the success of the proposed scheme and obligations of the principal debtor. The review

25 *Re NN2 Newco Ltd* [2019] EWHC 1917 (Ch). In this case, NN2 was specifically incorporated in England for the purposes of facilitating a scheme of arrangement. Upon incorporation, NN2 voluntarily became co-issuer and co-obligor under financial obligations, assuming joint and several liability under the debt instruments. The court noted that such a technique to create jurisdiction for a scheme was not abusive. Also, *Re Codere (UK) Ltd* [2015] EWHC 3778 (Ch).

26 *In the Matter of Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch). In this case, a scheme company was a guarantor rather than a borrower. It was incorporated in England and Wales. The borrowers were incorporated in Luxembourg and Switzerland and might not have been able to establish a sufficient connection with the UK. Under the credit agreement, the borrowers did not have a right of contribution or indemnity against the guarantors, so a claim against them would not ricochet against the scheme guarantor. In order to change this and create such a ricochet claim, the scheme company entered into a deed in favour of the borrowers. Under this deed, it assumed the position of a primary obligor, alongside the borrowers, so that each of them would have a right of contribution against the other.

27 C. Pilkington, Schemes of Arrangement in Corporate Restructuring, Sweet & Maxwell, 2017, para. 9-001, noting that there are four main categories of third parties for whose benefit a release is often granted, namely: (i) third party security providers (e.g. operating company guarantors); (ii) advisers; (iii) directors; and (iv) administrators or liquidators.

28 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2014, pp. 23-24.

29 *In the matter of Syncreon Group BV* [2019] EWHC 2412 (Ch), 2019 WL 04279919, at 26, briefly noting that the scheme companies confirmed the need of third-party releases "in order to give full effect to the schemes" and that such releases are "a relatively regular feature of the schemes." The court mentioned that the release provisions were explained to creditors.

of recent cases shows that the requirement of "close connection" is not closely examined by courts.[30] In any case, claims under cross-guarantees are seen as closely connected to the creditor's claim against the principal debtor, as both claims aim to recover the same loss.

- Creditors' rights against a third party must be personal and not proprietary (i.e. not based on creditors' title over assets).
- A creditor should benefit from a release of his rights against the third party "to the extent that if it were to exercise them this would adversely affect what it might recover under the scheme."[31]

The question remains whether the scheme of arrangement can be approved if, as a result of a third-party release, the guaranteed creditor is disadvantaged. It is essential to note that the majority of English schemes of arrangement are uncontested. Therefore, the issue of third-party releases and their fairness is rarely explicitly addressed by English courts. However, the compliance of third-party releases with the constitutional protection of private property was discussed by the High Court of Ireland in *Re Ballantyne Re PLC*. In this case, the court observed that "the requirement to obtain the sanction of the Court for a scheme of arrangement […], which sanction will not be granted if this scheme is unfair, inequitable, improperly coercive or unreasonable […], combined with the requirement for a special majority at the relevant scheme meeting as a pre condition for such sanction […], represents a fair, reasonable and proportionate balance […] of the various potentially competing interests involved in a scheme of arrangement."[32]

English courts are likely to follow the same approach. They are generally unwilling to replace the will of the majority of creditors with their own views on the commercial merits or on what is reasonable.[33] When deciding whether to sanction a scheme, courts consider whether there are reasons to doubt that the majority of creditors have made a decision that a reasonable creditor would have arrived at when assessing the proposal. Yet it is important to keep in mind that the court's sanctioning of a scheme is not a rubber-stamping exercise, even if the scheme is supported by the majority

30 See *In the Matter of Noble Group Limited* [2018] EWHC 3092 (Ch), at 25, noting that "[t]he jurisdiction is not […] limited to guarantees and claims closely connected to scheme claims."

31 J. Payne, Schemes of Arrangement: Theory, Structure and Operation, CUP, 2014, p. 31.

32 *Re Ballantyne RE Plc & Companies Act 2014* [2019] IEHC 407, at 130.

33 *Re Equitable Life Assurance Society* [2002] EWHC 140 (Ch). See G. McCormack, The European Restructuring Directive, Edward Elgar Publishing, 2021, paras. 6.47-6.50, describing the "creditor democracy" approach adopted with respect to schemes of arrangement.

of voting creditors.[34] In considering the general fairness of a scheme, the court may scrutinise a third-party release and its effect on a guaranteed creditor. If the release is fully disclosed and is not manifestly unfair, it is likely to be sanctioned by the court.[35] This might be the case where evidence demonstrates that an insolvent liquidation is a likely scenario if the scheme is not approved, and that the scheme provides each scheme creditor with a better return than they would receive in an insolvency proceeding.[36]

By contrast, if a scheme of arrangement with a third-party release is forced on a guaranteed creditor, deprives him of the benefits of the guarantee, and worsens his position compared to an alternative scenario, there can be valid concerns about the inherent unfairness of the release and of the scheme itself. This was confirmed in the context of CVAs. For example, in *Mourant & Co Trustees Ltd v. Sixty UK Ltd*, the court found that an alternative to the CVA, the liquidation, would not deprive the landlords of the guarantees for the remainder of the leases, which the CVA would do.[37] The guarantees were of obvious commercial value, and the very reason they were given in the first place was to protect landlords in case of tenant default. The release was therefore not sanctioned. Thus, the issue of fairness may arise when a particular creditor has a more tangential claim against a third party, and this claim is being compromised through a release. Such a claim can be based on a guarantee.[38]

The existence of a separate claim could also be relevant for class composition.[39] The recent case of *Gategroup* highlights this issue. Gategroup, a

34 *Re Stemcor Trade Finance Limited* [2015] EWHC 2803 (Ch); *Re Sunbird Business Services Limited* [2020] EWHC 2493 (Ch); *Re All Scheme Limited* [2021] EWHC 1401 (Ch) (given specific circumstances of the case (e.g. low level of creditor turnout, limited financial sophistication and literacy of creditors, unsatisfactory presentation of realistically probable alternatives to the scheme), the court questioned fairness of the scheme whereby the creditors were to suffer a 90% haircut, while the shareholders retained their economic interest in the group).

35 C. Pilkington, Schemes of Arrangement in Corporate Restructuring, Sweet & Maxwell, 2017, para. 9-021.

36 *Re Lecta Paper UK Ltd* [2020] EWHC 382 (Ch), at 29. The relevance of the comparator to the scheme, or the counterfactual of what would be an alternative if the proposed scheme does not proceed was considered in *Re Stronghold Insurance Co Ltd* [2019] BCLC 11, at 49, stating that "[…] only by identifying the comparator can the likely practical effect of what is proposed be assessed and the likelihood of sensible discussion between the holders of rights so affected and between them and others with different rights be weighed fairly."

37 *Mourant & Co Trustees Ltd v. Sixty UK Ltd* [2010] B.C.C. 882.

38 See *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), at 206.

39 *Re Noble Group Ltd* [2018] EWHC 3092 (Ch), at 26, suggesting that "issues of class composition could arise on the facts if, for example, some but not all scheme creditors had such a claim against a third-party adviser." The leading case on class composition is *Sovereign Life Assurance v. Dodd* [1892] 2 QB 573, per Bowen LJ at 583, holding that a class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Other relevant cases include *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241 and *Re UDL Holdings Ltd* [2002] 1 HKC 172.

leading global provider of airline catering services, experienced a massive decline in business due to the Covid-19 pandemic. To avoid insolvency, a Part 26A restructuring plan was proposed.[40] The plan involved two groups of creditors: Bondholders and Senior lenders. The rights of these creditors were guaranteed by the specifically incorporated Plan Company via the Deed Poll, under which the Plan Company undertook to indemnify the creditors in respect of the obligations of primary obligors. It is important to note that the primary obligors under bonds and loans were *different group entities*. The main question was whether there should be one or two classes of creditors. The court refused to put Bondholders and Senior Lenders in a single class, as their rights were considered to be "materially different, being against different entities [different obligors]."[41] The court also considered that the rights conferred by the plan on the respective creditors were different. For example, maturity dates were not the same, reflecting the existing contractual rights. The relevance of the rights against third parties (e.g. group guarantors) for class composition has been confirmed more recently.[42]

10.2.3 The USA: third-party releases in Chapter 11

Explaining the attractiveness of Chapter 11 among foreign companies, McCormack mentions several factors: (i) the worldwide automatic stay; (ii) the DIP regime; (iii) developed rules on rescue financing; (iv) cram down possibilities; and (v) procedural consolidation.[43] The availability of third-party releases is not cited. This section explains why this is the case. The position of US bankruptcy law on third-party releases is complex and unsettled. To clarify the current US approach, three points should be made.

First, US courts distinguish between a temporary injunction staying the enforcement and suits against third parties, and a permanent release of claims against them. It is generally accepted that injunctions to protect third parties, such as guarantors and co-debtors, are permissible in certain circumstances (see further section 11.3.2.).

40 In *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2191 (Ch), at 45-48, it was concluded that the same approach to class constitution applies to a Part 26A plan as to a Part 26 scheme of arrangement.

41 *Re Gategroup Guarantee Limited* [2021] EWHC 304 (Ch), at 189.

42 *Virgin Active Holdings Ltd & Ors, Re Part 26A of The Companies Act 2006* [2021] EWHC 814 (Ch), at 81.

43 G. McCormack, Bankruptcy Forum Shopping: The UK and US as Venues of Choice for Foreign Companies, International and Comparative Law Quarterly, Vol. 63, 2014, p. 827.

Second, US courts usually approve third-party releases when there is affirmative and explicit consent by creditors whose claims are being released.[44] Differing opinions, however, exist about what constitutes "consent", and whether deemed or implied consent suffices to sanction a third-party release.[45] Some courts find voting in favour of a reorganisation plan sufficient to assume consent to a third-party release included therein,[46] whereas other courts require manifest assent to the release, so that mere voting for a plan is not enough.[47] The third category of courts considers abstaining from voting or failure to opt out as consent.[48] The Commission established by the American Bankruptcy Institute to study the reform of Chapter 11 in its report favours express consent to the release, which covers: (i) voting for a plan that includes a third-party release; (ii) a separate point on the ballot indicating consent to a release; or (iii) a separate agreement with the affected creditor approving the release.[49]

Third, non-consensual third-party releases are particularly problematic in US bankruptcy law. It is difficult to summarise the position of US courts on the issue, as there is no harmonised and consistent approach, but rather a great variety of varying and, at times, conflicting approaches. This issue has split the federal circuits for decades. US statutory law does not expressly and unequivocally permit third-party releases, except in asbestos-related liability.[50] In fact, § 524(e) states that a "discharge of a debt of the debtor *does not affect the liability of any other entity* on, or property of any other entity for,

44 *In re SunEdison, Inc.*, 576 B.R. 453, 458 (Bankr. S.D.N.Y. 2017); *In re Specialty Equip. Cos., Inc.*, 3 F.3d 1043, 1047 (7th Cir. 1993).

45 See D. Coco, Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law, Fordham Law Review, Vol. 88, 2019, p. 233, arguing that the existing divergence in case law leads to inconsistent application of the US Bankruptcy Code, raises due process concerns, and causes forum shopping.

46 *In re Chassix Holdings Inc.*, 533 B.R. 64 (Bankr. S.D.N.Y. 2015); *In re Zenith Elecs. Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999).

47 *In re Digital Impact, Inc.*, 223 B.R. 1, 14-15 (Bankr. N.D. Okla. 1998), emphasising that the court "must ascertain whether the creditor unambiguously manifested assent to the release of the nondebtor from liability on its debt."

48 *In re DBSD N. Am., Inc.*, 419 B.R. 179, 217-19 (Bankr. S.D.N.Y. 2009), holding that "[e]xcept for those who voted against the Plan, or who abstained and then opted out, […] Third Party Release provision [is] consensual." *In re Indianapolis Downs, LLC*, 486 B.R. 286, 306 (Bankr. D. Del. 2013), stressing that "parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots."

49 ABI Commission to Study the Reform of Chapter 11, Final Report and Recommendations, 2014, p. 255.

50 11 U.S. Code §524(g)(1)(B). Even in asbestos-related cases, it is not entirely clear whether liability, other than the derivative liability of the debtor, can be released. J.M. Silverstein, Overlooking Tort Claimants' Best Interests: Non-Debtor Releases in Asbestos Bankruptcies, UMKC Law Review, Vol. 78, 2009, p. 63, arguing that the language of this section "suggests that supplemental injunctions may not extinguish rights against a third party arising from the *third party's independent conduct*" (original emphasis).

such debt"[51] (emphasis added). Courts grapple with the scope and application of this provision. A few circuits (Ninth,[52] Tenth,[53] and Fifth[54] circuits) have adopted a restrictive view on third-party releases, ruling that § 524(e) prohibits them.[55] Other circuits avoid this narrow interpretation and, under certain limited conditions, are willing to consider and approve third-party releases. They focus on § 105(a), which grants US courts the equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the US Bankruptcy Code]."[56] Yet even for them, the permissibility of third-party releases does not result in a single judicial standard.

For instance, in *Dow Corning Corporation*, the Sixth Circuit listed seven factors necessary for the approval of a third-party release. According to these, a release can be granted if:

> (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific

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51 11 U.S. Code §524(e).

52 *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1402 (9th Cir. 1995), restating that "[t]his court has repeatedly held, without exception, that §524(e) precludes bankruptcy courts from discharging the liabilities of nondebtors."

53 *Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa (In re W. Real Estate Fund, Inc.)*, 922 F.2d 592, 601 (10th Cir. 1990), holding that "Congress did not intend such [discharge of debt] to third-party bystanders."

54 *Bank of N.Y. Tr. Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 252 (5th Cir. 2009).

55 For criticism of the position that § 524(e) bars third-party releases, see R. Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations, University of Illinois Law Review, Vol. 1997, 1997, p. 971, arguing that while "a bankruptcy court does, indeed, lack the authority to approve a nonconsensual release of creditors' non-debtor claims, courts' and commentators' reliance upon section 524(e) as a statutory prohibition is misguided and unfortunate. Section 524(e) is necessary, as a matter of mere mechanics, to prevent the debtor's discharge from automatically discharging co-debtors and guarantors, through the operation of common-law suretyship rules that release secondary obligors upon release of the primary obligor."

56 11 U.S. Code §105(a).

factual findings that support its conclusions.[57]

A comprehensive analysis of the different tests applied by circuits in adjudicating the issue of third-party releases falls outside the scope of this book. Some circuits prohibit them, noting that they contravene the statutory language of § 524(e) of the US Bankruptcy Code. Others apply the heightened scrutiny standard,[58] highlighting that third-party releases can be allowed in rare, unique and unusual cases,[59] where the release is "integral" to and "absolutely required" for the reorganisation.[60]

The hesitation of US courts in approving non-consensual releases can also be explained by the risks of their abuse. As the court in *Metromedia* warned, "a nondebtor release is a device that lends itself to abuse. […] In form, it is a release; in effect, it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code."[61] The availability of third-party releases has recently entered the spotlight in view of the Purdue Pharma's Chapter 11 plan of reorganisation. This plan included a settlement with the Sackler family, whereby, in exchange for the release of third-party claims against over 1,000 individuals and entities related to the Sackler family ("shareholder released parties"), the Sacklers initially agreed to provide USD 4.275 billion towards the insolvency estate; that number reached appr. USD 6 billion on appeal. The release was to extend to all present and potential claims connected to the opioid crisis. The plan was approved by well above the 75% supermajority in each class of creditors and was confirmed by the Bankruptcy Court for the Southern District of New York (Judge Drain) in September 2021.[62] The court ruled that the settlement was necessary for the plan and that the plan was reasonable and fair. On appeal, the Bankruptcy Court's confirmation order was vacated. The

57 *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002). The same factors are applied by the Fourth Circuit, see *Nat'l Heritage Found., Inc. v. Highbourne Found.*, 760 F.3d 344, 348-51 (4th Cir. 2014). In its recommendations (p. 256), the ABI Commission rejected the application of the Dow Corning factors and favoured a different test applied in *Re Master Mortg. Inv. Fund Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994).

58 The trend towards an increasingly restrictive interpretation has also been noted in the literature. See M.S. Etkin, N.M. Brown, Third-Party Release? – Not So Fast! Changing Trends and Heightened Scrutiny, AIRA Journal, Vol. 29, 2015, p. 26, concluding that "a focus on the courts' application of the standards illustrates the movement of the Permissive Circuits towards a more restrictive view."

59 *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 141 (2d Cir. 2005); *In re Dow Corning Corp*. 280 F.3d 648, 657–58 (6th Cir. 2002), stressing that a third-party release is "a dramatic measure to be used cautiously." *In re Transit Grp., Inc.*, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002), explaining that courts that grant third-party releases "hold that the granting of such releases is justified only in unusual circumstances."

60 *In re Millennium Lab Holdings II, LLC.*, 945 F.3d 126, 137 (C.A.3 (Del.), 2019).

61 *In re Metromedia Fiber Network, Inc.*, 416 F.3d 136, 142 (2nd Cir. 2005).

62 *In re Purdue Pharma L.P.*, 633 B.R. 53 (Bankr. S.D.N.Y. 2021).

US District Court for the Southern District of New York (Judge McMahon) concluded, in a rather broad statement, that the US Bankruptcy Code did not authorise non-consensual non-debtor releases.[63] Finally, the cases ended up in the Court of Appeals for the Second Circuit, which overturned the US District Court's ruling and held that the Bankruptcy Court's initial approval of the releases was appropriate.[64]

In light of the heated debates about the lawfulness and desirability of bankruptcy third-party releases, and given the split between circuits regarding this practice, a bill titled the "Nondebtor Release Prohibition Act of 2021" was proposed in July 2021.[65] This bill aims to prohibit non-consensual, non-debtor releases in bankruptcy proceedings. On this point, it should be noted that the bill was triggered by cases like Purdue Pharma, involving mass torts, rather than by reorganisations of corporate groups and the restructuring of liability from intra-group financing – the main subject of this book.[66] It appears that the negative attitude and high scrutiny apply primarily to mass tort releases, and not necessarily to the restructuring of group guarantees.

10.2.4 The Netherlands: third-party releases in WHOA schemes

10.2.4.1 General release framework

Prior to the adoption of the WHOA, Dutch law did not have statutory rules dealing with third-party releases. Outside the WHOA framework, examined below, the possibility of releasing third parties in plans adopted in bankruptcy and suspension of payments procedures remains unclear. In academic literature, the predominant view seems to be that such releases are only available if the creditor consents to a release.[67]

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63 *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y., 2021).

64 *In re Purdue Pharma L.P.*, No. 22-110, 2023 WL 3700458 (2d Cir. May 30, 2023).

65 H.R.4777 - Nondebtor Release Prohibition Act of 2021.

66 For the analysis of third-party releases in bankruptcy proceedings involving mass-tort liability, see L.D. Simon, Bankruptcy Grifters, The Yale Law Journal, Vol. 131, 2022, pp. 1154-1216; R. Brubaker, Mandatory Aggregation of Mass Tort Litigation in Bankruptcy, The Yale Law Journal Forum, Vol. 131, 2022, pp. 960-1009; E.J. Janger, Aggregation and Abuse: Mass Torts in Bankruptcy, Fordham Law Review, Vol. 91, 2022, pp. 362-383; A.J. Casey, J.C. Macey, In Defense of Chapter 11 for Mass Torts, The University of Chicago Law Review, Vol. 90:3, 2023, pp. 973-1021.

67 S.C.J.J. Kortmann, Derden in het faillissementsrecht (1997) 46 AA 5, p. 59-60; A.D.W. Soedira, Het Akkoord. Een wetenschappelijke proeve op het gebied van de rechtsgeleerdheid (Onderneming en recht, nr. 60) (diss. Nijmegen), Deventer: Kluwer, 2011, p. 93-96; A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020, p. 495ff; B. Wessels, Het Akkoord (Wessels Insolventierecht nr. VI), 5e druk, Wolters Kluwer, 2020, 6159ff; K. Harmsen, Lehman Brothers: een akkoord in strijd met de Faillissementswet, TvI 2013/28.

This position is substantiated with reference to the nature of a plan, which is seen as an agreement between the debtor and its creditors, and which therefore requires creditor consent (*aanvaarding*). In other words, the binding effect of a release arises from such consent rather than from a court approval of a plan. The release provisions are believed to be extraneous to a plan (*akkoordvreemde bepalingen*), as they do not concern the debtor-creditor relationship but regulate creditor-third party relationship. However, Vriesendorp and Hermans,[68] and Tollenaar[69] argue that a plan should be able to affect creditors' rights against third parties, even over creditors' disagreement. Be it as it may, in practice, third party releases have been included in bankruptcy and suspension of payments plans.[70] They purported to release, among others, debtor's directors, bankruptcy trustees, direct and indirect shareholders, group members, their insurers and advisors from potential liability vis-à-vis creditors who were part of the plan. Yet these third-party releases were either not challenged or not invoked after the approval of a plan. Hence, the limits of what could be agreed in a plan have not been tested in courts. The same is true for WHOA plans that contain releases of directors, board members, agents and other parties, whose releases are not based on any specific statutory rule.[71] This is different for releases of group members discussed below.

As previously noted, the starting point is that a WHOA scheme, just like any other procedure under the Dutch Bankruptcy Act, does not affect creditors' rights vis-à-vis third parties, i.e. guarantors and co-debtors, who are liable for the debt of the debtor proposing the plan.[72] In the context of group financing, where several group members give security or act as co-borrowers, this means that the restructuring of obligations of one group member does not affect creditor's rights against other group members. Such group members remain liable to pay the debts which have been restructured. This could lead to their insolvency and, given group operational and financial interdependence, it can undermine the chances for the survival of the restructured debtor. If so, the goal of rescuing the viable business will not be achieved. With this in mind and to facilitate restructuring within enterprise groups, the Dutch Bankruptcy Act in its articles on WHOA schemes,

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68 R. Hermans, R.D. Vriesendorp, Het dwangakkoord in het insolventierecht: vrijheid in gebondenheid? TvI 2014/10.

69 N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer, 2016, p. 300-302.

70 Rb. Amsterdam 22 March 2013, *JOR* 2013/191, m.nt. W.J.M. van Andel (*Lehman Brothers Treasury Co. B.V.*); Rb. Amsterdam 23 September 2021, *JOR* 2022/17, m.nt. R.J. van Galen (*Steinhoff International Holdings N.V.*).

71 Rb. Amsterdam 21 June 2023, ECLI:NL:RBAMS:2023:4152 (*Steinhoff International Holdings N.V.*), 12.10., noting that the "court sees no grounds for rejecting the homologation request in the foregoing, noting that the court will not rule on whether the Release Clause can be invoked by or against third parties after homologation."

72 Dutch Bankruptcy Act, Article 370(2) and Article 160.

provides an exception to the general rule of "no-third-party-effect". It offers a debtor or a restructuring expert the option to propose the restructuring of group obligations under a single plan.[73] Without this option, each member of a group would need to initiate its own proceedings to restructure obligations under the guarantees.

The WHOA introduced Article 372 Fw, which establishes that a WHOA plan can amend the rights of creditors against third parties (non-debtors), which must be debtor's group members. This is possible if these group entities have not offered a plan to restructure relevant obligations themselves. The definition of a "group" under Dutch law was discussed in section 2.3. In the ensuing paragraphs, we will first address the scope of the rules on third-party releases, and then provide an overview of the conditions for a third-party release.

When it comes to the (personal) scope, a WHOA plan can amend the rights of creditors against group entities, provided that the rights against such entities entail payment of or provision of security for the obligations of the debtor or obligations for which these legal entities are liable together with or alongside the debtor. Going back to the example of a group mentioned earlier, if Company A is the principal debtor (borrower) and Company B provided a guarantee to secure Company A's obligation to the Bank, a WHOA plan adopted for Company A could amend the Bank's claim against Company B. This is a simple case. The application of the WHOA's rules in other cases may be less straightforward. Two such cases are identified below.

73 A restructuring expert (*herstructureringsdeskundige*) is an independent insolvency officer who can be appointed by the court to develop and propose a WHOA plan to the debtor's creditors and shareholders, or to some of them. See Article 371 Fw. The appointment of a restructuring expert does not mean that the debtor ceases to be a debtor in possession; the debtor does not lose any powers other than those related to the WHOA plan.

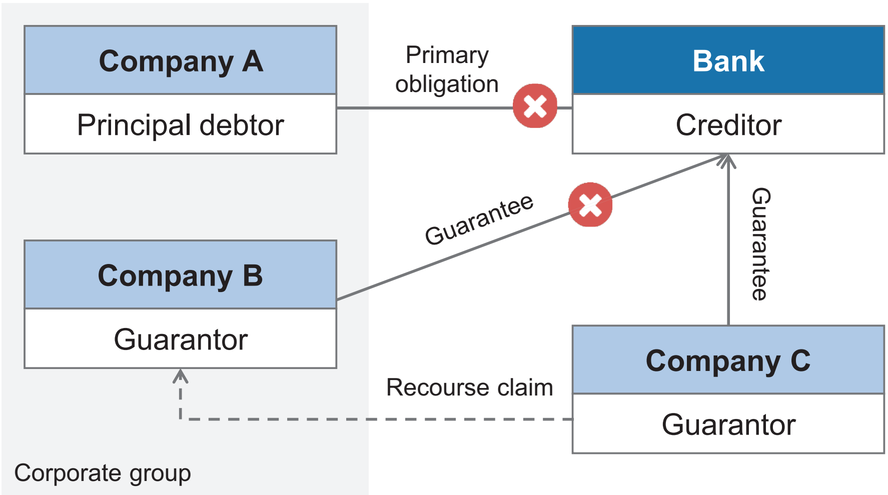

Figure 11. Third-party release with a non-group guarantor (Case 1)

The first case has the same facts, except that there is a non-group entity, Company C, which has also guaranteed Company A's obligations. Let us assume that upon payment to the Bank, Company C is entitled to collect from Company B in full. Company A initiates a WHOA procedure and proposes a plan that releases the obligations of Company B, so that the Bank cannot force it to pay. However, this WHOA plan does not release Company C from its obligations under the guarantee since Company C is not part of the enterprise group. This is why the Bank is not prevented from suing Company C for the full outstanding amount. In turn, Company C can sue Company B based on a *regres* claim. If such a claim threatens the group restructuring, a third-party release is of limited use. This example demonstrates the limitations of the Dutch approach to third-party releases. While it is clear that a WHOA scheme can release group entities on obligations owed by the debtor, it is less clear whether it can release a non-debtor group entity (Company B) from obligations owed to its own creditors. The most likely answer is that it cannot. Therefore, Company B needs to start its own WHOA procedure and restructure debts owed to Company C.

The second case involves the same groups of companies, but there is another group entity, Company D that has extended a guarantee to the Bank. Thus, there are two group members, Company B and Company D, acting as guarantors for Company A's obligation (first-level guarantees). In addition to guaranteeing the debt of the principal debtor, Company A, Company B and Company D have guaranteed the obligations of each other (second-level guarantees). In other words, the guarantors have cross-guaranteed each other's obligations to the Bank, and in this way, they have become the principal debtors to each other. As in the case above, the WHOA plan releases the initial, first-level guarantees. Does it also release second-level guarantees?

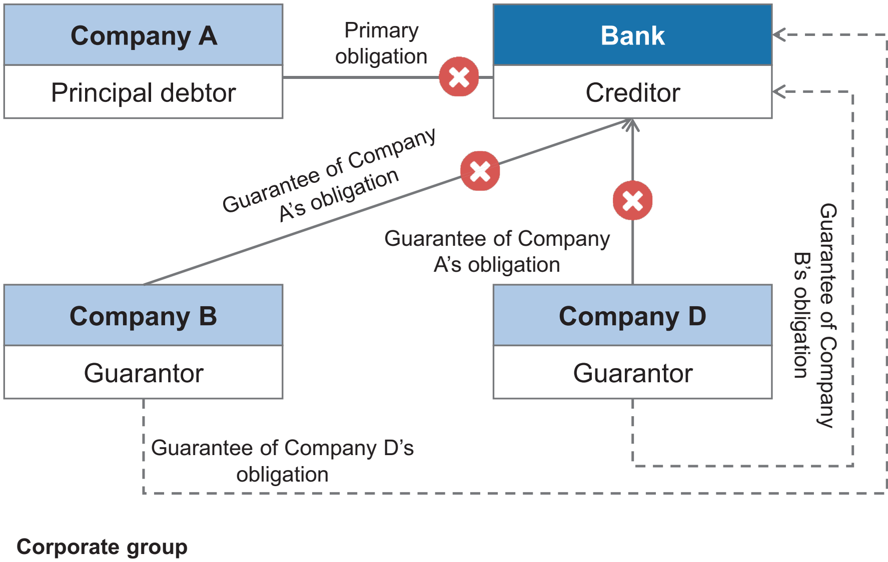

Figure 12. Third-party release and cross-guarantees between guarantors (Case 2)

As a general rule, a surety is liable for the original debt, even if such debt has been restructured in a WHOA plan. Therefore, one could argue that the second-level guaranteed debt survives the release of the first-level guarantees. However, the question remains whether a WHOA plan can also release second-level obligations. Providing a definitive answer to this question is difficult. Article 372 Fw states that a WHOA plan may amend the rights of creditors against group members, but only if the creditors' rights against such group members are intended to satisfy or secure the performance of obligations of the scheme debtor or obligations for which those legal persons are liable with or in addition to the scheme debtor. In our case, Company B and Company D have guaranteed each other's obligations. These obligations are separate and distinct from the obligations of the scheme company (Company A). Consequently, we are dealing with two separate *principal* obligations. Since neither of the guarantors – each being the principal debtor to each other – is subject to a WHOA scheme, their own separate obligations may not be released by Company A's plan. If Company A has also provided a guarantee securing the obligations of its guarantors (which is unlikely), then such a release is possible, as the WHOA debtor would be a holder of the principal obligation.

One potential way to solve this puzzle is to open separate WHOA procedures for Company B and Company D and release their obligations in such procedures.[74] Yet this approach creates costs and weakens the legal framework for third-party releases, which aims to resolve intra-group obligations in one go. Nevertheless, one may argue that the obligations of the guarantors (Company B and Company D) under second-level guarantees are derived from the primary obligation of the scheme debtor (Company A), and hence should be capable of being released in the latter's WHOA plan.

10.2.4.2 Conditions for a third-party release

The Dutch Bankruptcy Act lists several conditions for third-party releases.

- First, claims against third parties should be ancillary to the obligations of the anchor debtor – a scheme company.[75] This means that the right of a creditor against a third party should involve the payment of or security for the obligations of the anchor debtor, or the obligations for which the third party is liable together with the anchor debtor. The obligations of group members capable of being released in a WHOA plan are given a broad interpretation and may include, inter alia, liabilities arising from the relationship of suretyship, co-debtorship and a 403-statement. It is also possible to release group obligations in a situation where the anchor debtor is not the principal debtor but a (co-)guarantor.[76] In this respect, Dutch law aligns with English case law with its flexibility. Yet, unlike English law, Dutch law does not provide for the release of persons other than group members, such as directors, insurers, legal and financial advisers.
- Second, a third party benefitting from a release must itself be in a state of financial distress,[77] so that it can reasonably be assumed that it will not be able to continue paying its debts as they fall due.[78] The foreseen financial distress may be connected to the enforcement of a guarantee or another intra-group liability arrangement. In integrated groups, group financial distress normally entails impending insolvency not only of the principal debtor but also of group guarantors. The requirement of

74 N.B. Pannevis, Insolventierecht, Deventer: Wolters Kluwer, 2022, 29.4.4., observing that if "the co-debtors wish to restructure their own debts in addition to their liability for the debt of the plan provider, for which they are jointly and severally liable, they could offer their own plans at the same time. Then there will be several plans. These plans can be handled jointly and, for example, be offered in a single document […]." Rb. Amsterdam 5 August 2021, ECLI:NL:RBAMS:2021:6519, *JOR* 2022/102, m.nt. R. van den Sigtenhorst.

75 Dutch Bankruptcy Act, Article 372(1)(a).

76 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 372 Fw.

77 Dutch Bankruptcy Act, Article 372(1)(b).

78 Dutch Bankruptcy Act, Article 370(1). The Explanatory Memorandum defines this access criterion as "imminent insolvency" or "unavoidable insolvency". MvT, *Kamerstukken II* 2018/19, 35249, 3. This is a situation where the debtor has not yet ceased to pay its debts and is still able to meet its current obligations, but the debtor foresees that there is no realistic prospect of averting future insolvency if its debts are not restructured.

financial distress is added to prevent situations in which creditors are barred from pursuing their claims against solvent group members.

- Third, the group entities concerned need to consent to the release, or the plan should be proposed by a restructuring expert pursuant to Article 371 Fw.[79]
- Fourth, the court should have jurisdiction over third parties in a situation where these legal entities would themselves offer a restructuring plan.[80] In a public procedure, this amounts to either the presence of COMI or establishment (as defined under the EIR Recast) of all relevant group entities in the Netherlands,[81] or of the presence of their COMI or establishment in a non-EU jurisdiction (or in Denmark, as it falls outside the EIR Recast regime).[82] In a non-public WHOA procedure, sufficient connection to the Netherlands suffices.[83]

Additionally, the law stipulates that when deciding on the request to confirm a WHOA plan that restructures claims against guarantors, a court, on its own initiative (*ex officio*) or upon request, assesses whether the proposed plan "in respect of these third parties" (*ten aanzien van deze rechtspersonen*) complies with the general confirmation criteria contained in Article 384 Fw.[84] In other words, the statutory confirmation criteria should be satisfied with respect to each third party, whose obligations are restructured via the plan. This is a rather peculiar norm that does not have analogues in US or UK law.

Following this norm, for example, similar to the scheme company, the guarantor must be in a state of impending financial distress. The plan or supplementing documents, as prescribed by Article 375 Fw, should encompass all relevant information covering the group entities benefiting from a

79 Dutch Bankruptcy Act, Article 372(1)(c).

80 Dutch Bankruptcy Act, Article 372(1)(d).

81 The public WHOA scheme (*De openbare akkoordprocedure buiten faillissement*) is covered by the jurisdictional rules of the EIR Recast. See Regulation (EU) 2021/2260 of 15 December 2021 amending Regulation (EU) 2015/848 on insolvency proceedings to replace its Annexes A and B. A non-public WHOA scheme does not fall within the scope of the EIR Recast.

82 Dutch Bankruptcy Act, Article 369(7). Where COMI of a group entity is not in the EU (or is in Denmark), rendering the EIR Recast inapplicable, the jurisdiction of Dutch courts with respect to a public WHOA proceeding is determined on the basis of Article 3 of the Dutch Code of Civil Procedure. For the discussion of jurisdictional aspects of WHOA schemes and third-party releases, see R. Warner and M. Veder, Enterprise Group Restructuring: Dutch Options and United States Enforcement, European Insolvency and Restructuring Journal, 2021-7, 2021.

83 Dutch Code of Civil Procedure, Article 3, establishes a flexible jurisdictional basis, under which Dutch courts have jurisdiction when either the applicant or, where there are multiple applicants, one of them has its domicile or habitual residence in the Netherlands, or when the case is otherwise sufficiently connected to the Dutch legal system. Such connection may result from jointly-owed or guaranteed debt with a Dutch group member. See MvT, *Kamerstukken II* 2018/19, 35249, nr. 3.

84 Dutch Bankruptcy Act, Article 372(2)(b).

third-party release, as if such entities were to offer separate WHOA plans. This comprehensive information should include details about their financial position, as well as a properly documented statement of income and expenditures.[85] Since the group plan, referred to in the Dutch parliamentary documents as a "broad agreement" or "*breed akkoord*"[86], must meet the conditions related to disclosure and content with respect to each third party, some authors suggest that such a plan effectively incorporates "mini-plans" offered by relevant group companies.[87] We will revisit this view and explore potential problems it may create later in this chapter.

For the approval of a WHOA plan, a crucial issue is the formation of classes of creditors. Once it is determined which creditors are affected by the plan, the next question is whether these creditors will vote in one class or whether the plan provides for a class division. This division must meet the requirements of Article 374 Fw, which states that the division of creditors into classes should consider the rights that creditors have in the event of the realisation of the debtor's assets in bankruptcy or the rights given to them under the plan. Creditors should be allocated to separate classes if their rights are so different that they cannot be said to be in a comparable position. One court explained that "a correct class division gives meaning to the vote and a democratic justification for attributing legal effect to the majority opinion."[88]

In any event, creditors who have a different rank in insolvency must be divided into separate classes.[89] The question is whether creditors with claims against group guarantors should be placed in separate class(es). The answer will depend on whether the rights of such creditors against the guarantors are affected by the plan. In a recent case, the creditor argued that its position was significantly different from that of other unsecured creditors because it could enforce a guarantee if the principal debtor went bankrupt. Hence, the creditor contended that it should be placed in a separate class. The court rejected this argument and stated that the existence of a claim against the guarantor did not influence the position of the creditor

85 Dutch Bankruptcy Act, Article 375(2)(a) and 375(3)(d). See N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016, 8.11, explaining that information about the financial position of a third party needs to be provided to enable the affected creditors to make an informed decision about the proposed amendment or waiver of claims against the third party.

86 *Kamerstukken II* 2018/19, 35249, nr. 3, p. 44.

87 R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 372 Fw. Also, R. van den Sigtenhorst, Herstructurering van groepen onder de WHOA, in: C.M. Harmsen & M.L.H. Reumers (red.), De WHOA van wet naar recht (Recht & Praktijk, nr. InsR18), Deventer: Wolters Kluwer 2021, 8.3.4; A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020, 7.7.3.3.

88 Rb. Amsterdam 24 December 2021, ECLI:NL:RBAMS:2021:7643, r.o. 7.8.2.

89 Dutch Bankruptcy Act, Article 374(1).

under the plan or its recovery in the alternative (bankruptcy) scenario.[90] It is important to point out that the case at hand did not involve a third-party release.[91]

The outcome might be different if the creditor's rights against the guarantor are restructured in the plan. The reason for this is that the guaranteed creditor's position will be distinct from that of creditors who solely have a claim against the principal debtor, and this distinct position is specifically addressed (or altered) by the plan. As a result, guaranteed creditors subject to the effects of a third-party release should constitute a separate class or even classes of creditors.[92] The division of different guaranteed creditors into separate classes may be justified when their positions in the alternative scenario (e.g., insolvent liquidation) are not identical. This could occur, for example, if their rights under the guarantees are enforceable against different group companies, resulting in varying estimated rates of recovery. Consequently, the impact of the WHOA plan on the guaranteed creditors would differ, necessitating the division into separate classes. However, there are instances where different guaranteed creditors could potentially be grouped in the same class. One such example involves bondholders under two separate note programs, both secured by cross-guarantees offered by

90 Rb. Limburg 8 October 2021, *JOR* 2022/20, m.nt. Tekstra. The same was held in Rb. Amsterdam 24 December 2021, ECLI:NL:RBAMS:2021:7643, r.o. 7.8.1. Similarly, the Grand Court of the Cayman Islands in *In the Matter of Ocean Rig UDW Incorporated, Drill Rigs Holdings Incorporated, Drillships Financing Holdings Incorporated and Drillships Ocean Ventures Incorporated (each in provisional liquidation)* 2017 (2) CILR 495 held that for the purpose of class composition, the "fact that certain creditors had rights against other entities within the group was irrelevant as rights against third parties were not to be taken into account." It should be noted that in this case, the guarantor companies were subject to separate schemes and no third-party release was involved.

91 However, Rb. Midden-Nederland 10 November 2021, ECLI:NL:RBMNE:2021:5531, *JOR* 2022/21, mr. drs. N.B. Pannevis. In this case, the court seems to indicate that the fact that a creditor may sue several jointly and severally liable debtors, each proposing a plan, may impact the class formation, because for such a creditor the (overall) rate of recovery is higher compared to creditors who can only sue individual debtors.

92 N.W.A. Tollenaar, Het pre-insolventieakkoord. Grondslagen en raamwerk (diss. Groningen), Deventer: Wolters Kluwer 2016, 8.11; A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer 2020, 7.7.3.3. R. van den Sigtenhorst, Herstructurering van groepen onder de WHOA, in C.M. Harmsen & M.L.H. Reumers (red.), De WHOA van wet naar recht (Recht & Praktijk, nr. InsR18), Deventer: Wolters Kluwer, 2021, 8.3.4, stating that it may be possible to put guaranteed creditors in the same class with non-guaranteed creditors, provided that (1) the position of the guaranteed creditors in bankruptcy, and (2) their rights under the plan do not differ to such an extent that there is no comparable position with creditors of the principal debtor with whom they are placed in one class. According to Van den Sigtenhorst, this is conceivable within groups, "certainly when there is a large or even complete financial interdependence." One can imagine a situation where group guarantees do not substantially affect the recovery rates of guaranteed creditors, for example, because the guarantors are hopelessly insolvent.

the same group members.[93] In this particular scenario, it might be easier to demonstrate that the actual (recovery) positions in the alternative scenario and under the plan do not substantially differ, making it unnecessary to classify them into separate classes.

Dutch law lays down the best-interest-of-creditors test as a key safeguard to protect the rights of creditors and shareholders. According to this test, "the court may refuse to confirm the plan […] if there is prima facie evidence that [the objecting] creditors or shareholders are worse off under the plan than they would have been in a liquidation of the debtor's assets in bankruptcy."[94] This provision ensures that a creditor cannot be forced to accept a smaller share in the value under the plan than it would receive in bankruptcy. If the creditor retains its claim against the guarantor, only the value of the principal debtor needs to be considered.[95] The situation changes when a WHOA plan includes a third-party release. A creditor whose rights under the guarantee are restructured and who did not support the plan may object to the plan's approval, citing a violation of the best-interest-of-creditors test.

If the creditor's claim against the guarantor is restructured, the court may be required to assess the payment the creditor would have received if it were to enforce such a claim. This exercise is inherently uncertain because it asks the court to explore a hypothetical scenario based on assumptions that are themselves uncertain. When dealing with intercompany guarantees, this exploration becomes even more complicated due to the need to examine the financial strength of the guarantor and determine the value of its assets and liabilities, including group liabilities and associated contribution issues. This problem is not new and has been previously mentioned in the context of transaction avoidance, where the difficulty of determining the value of a group guarantee and "predicting" an alternative (no-guarantee) scenario was emphasised (see Chapter 8). If the guarantor itself is insolvent or may become insolvent as a result of enforcement under the guarantee, the determination of prospective creditor pay-outs in its bankruptcy will have to be conducted.

93 See *Pathfinder Strategic Credit LP and another v. Empire Capital Resources Pte Ltd* [2019] SGCA 29, in which the issue of classification of guaranteed creditors was discussed. The question was whether the holders of different notes (2015 Noteholders and 2017 Noteholders), guaranteed by different group entities, should be classified as a single class for the purpose of voting on the scheme. The court observed that, assuming the alternative scenario is insolvent liquidation, the 2015 and 2017 Noteholders would be affected differently by the plan – the recovery rates in insolvency are different, but in the proposed scheme both creditors receive the same treatment. However, in the court's view, the difference in the recovery rates (i.e. 3%) was not significant enough to call for separate classes.

94 Dutch Bankruptcy Act, Article 384(3).

95 Rb. Limburg 8 October 2021, ECLI:NL:RBLIM:2021:8851, r.o. 3.3.21.

10.2.4.3 Potential impediments to third-party releases

The view of a group plan as encompassing mini-plans with respect to group guarantors might cause problems in practice. Two of the potential problems are discussed below.

First, let's imagine that a class of guaranteed creditors does not support the plan. Yet for the WHOA plan to be approved and crammed down on dissenting classes of creditors, if necessary, at least *one* in-the-money class of creditors must accept the plan.[96] Now, if we consider a third-party release as belonging to a separate mini-plan concerning the guarantor, and if we assume that the class of guaranteed creditors is the only class relevant for the approval of such a mini-plan (because the rights of other creditors and shareholders of the guarantor are not affected), the requirement of having "at-least-one-supporting-class" may not be complied with. As a result, the mini-plan and the third-party release contained therein will not take effect. This could present a roadblock to third-party releases.

Second, another example of a rule that may complicate the operation of a third-party release is the Dutch version of the absolute priority rule (APR). According to the Dutch Bankruptcy Act, the court shall refuse to confirm the plan if the distribution of value realised under the plan deviates to the disadvantage of the class that did not accept the plan from the ranking that applies upon the enforcement against the debtor's assets under Book 3, Title 10 BW ("Right of a creditor to take recourse against his debtor").[97] Again, if we adopt the "micro" view that a release falls under a separate mini-plan that needs to comply with key requirements, including compliance with the APR, if the affected class of guaranteed creditors does not support the plan, we may reach a conclusion that the plan violates the APR. This is because such a plan is likely to only affect guaranteed creditors and will probably not curtail the rights of lower-ranked creditors and shareholders of the group guarantor benefiting from the release.[98] After all, creditors and shareholders not involved in the plan will retain their entire claim against the group guarantor.

The first problem creates a strong holdout position for a class of guaranteed creditors, effectively blocking the possibility to cram down this class. One can also see this (essentially) veto right as an instrument of oppression by

96 Dutch Bankruptcy Act, Article 383(1).

97 Dutch Bankruptcy Act, Article 384(4)(b).

98 These potential obstacles to the adoption of a group plan were highlighted by A.M. Mennens, Het dwangakkoord buiten surseance en faillissement (Onderneming en recht nr. 118), Deventer: Wolters Kluwer, 2020, 7.7.3.3. Notably, the problem related to the APR rule does not arise in the UK, as this rule was not enacted in any form as a principle for the exercise of the discretion on sanctioning schemes of arrangement or Part 26A restructuring plans. *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), at 289.

the minority. This is why, in this particular case, it is preferable to look at the group plan alone[99] instead of sub-dividing it into mini-plans. This interpretation is supported by the wording of Article 383(1) Fw, which states that at least one class of creditors must accept *the plan* (and not one class *per each mini-plan*). It can also be inferred from the wording of Article 372(2)(b) Fw, which only refers to compliance with the requirements of Article 384 Fw and does not mention Article 383(1) Fw. The absence of a reference to Article 383(1) Fw in the final text of the WHOA is especially notable in view of the fact that the WHOA's Explanatory Memorandum contained such reference to Article 383(1).[100]

The advocated "group approach" should facilitate estate value maximisation, making third-party releases a workable tool with benefits of reduced transaction costs and expedient debt restructuring. Moreover, as long as the best-interest-of-creditors test is in place, this "group approach" appears to be balanced and does not disproportionately encroach on the principles of equal treatment of creditors, protection of legitimate expectations, and party autonomy.

As for the second problem, it can also lead to a holdout position of a guaranteed creditor. This time, it may be more difficult to overcome because, in the absence of substantive consolidation, the APR applies at an entity level rather than at a group level.[101] This follows from the doctrine of entity separateness, which means that the guarantor has a pool of creditors (liabilities) and assets, separate from that of the principal debtor. As a result, creditors are ranked separately per legal entity, in accordance with the statutory order of priority ("waterfall"). One should keep in mind that the APR ensures a fair distribution of reorganisation value, which refers to the value of the company after the plan approval and implementation.[102] To determine whether the reorganisation value is fairly distributed, the size of a creditor's claim must be compared with the relative claim that this creditor has in the reorganisation value. No priority issue arises if the reorganisation value exceeds the debts, because each class receives 100%, and creditors affected

99 This approach was taken by the US court *in JPMorgan Chase Bank v. Charter Commc'ns Operating, LLC (In re Charter Commc'ns)*, 419 B.R. 221, 266 (Bankr. S.D.N.Y. 2009). In this case, the group plan involved a group entity with only one creditor and this creditor voted against the plan. Section 1129(a)(10) Bankruptcy Code provides that a court cannot confirm a plan unless at least one class of impaired claims approves the plan. Yet the US court ruled that "[i]t is appropriate to test compliance with section 1129(a)(10) on a per-plan basis, not […] on a per-debtor basis."

100 *Kamerstukken II* 2018/19, 35249, 3.

101 The same applies to the best-interest-of-creditors test, which prescribes the determination of liquidation value per entity, see section 3.5.

102 Rb. Amsterdam 2 September 2021, ECLI:NL:RBAMS:2021:6521, r.o. 10.8.

by the plan are fully compensated.[103] In other words, the present value of what is offered to the creditors is equal to the amount of the claims of those creditors.

The situation is different if the reorganisation value is insufficient to cover all debts. In this case, if a class votes against, it must be determined, upon request, whether that class receives its share of the reorganisation value of the relevant entity under the plan in line with the statutory waterfall. Given that the Dutch Bankruptcy Act requires compliance with the APR in respect of third parties (e.g. group guarantors), finding a justification for fully or partially releasing or amending a creditor's claim against the group guarantor while leaving shareholders of this guarantor unaffected is challenging. The strict application of the APR suggests that shareholders are not allowed to retain their shareholdings in the guarantor against the will of (classes of) creditors, as long as the creditors have not been paid in full.

One way to address the described problem is to arrange for the restructuring at the level of the parent company. If shareholders are wiped out at this top level, the issues caused by the APR can be resolved with relative ease. Another way is to argue that the value of shares in the third-party guarantor is zero, and therefore keeping the shareholders does not give them any value ahead of creditors. Whether this argument is accepted by the courts will depend, among other factors, on the interpretation of "value" under Article 384(4)(b) Fw – i.e., whether worthless shares could be considered "value" or not.[104] In our view, even if the equity interest in the guarantor does not have a positive present market value, the power to control it and the right to participate in the distribution of future profits may lead to the conclusion that the presently worthless equity can be of value.

Finally, it is worth noting that the Dutch APR is not strict and offers the following exception. When the distribution deviates from the statutory priority of claims (bankruptcy "waterfall"), to have the plan approved, the debtor needs to demonstrate: (i) the reasonable grounds for such deviation, and (ii) that the interests of the dissenting creditors are not harmed under the plan.[105] The meaning of what is regarded as "reasonable grounds" has

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103 Rb. Amsterdam 3 November 2021, ECLI:NL:RBAMS:2021:6522, r.o. 9.17.

104 Note that the Dutch version of the APR refers to the distribution of "value" realised under the plan, whereas US law mentions "any property". In the past, some parties in US bankruptcy proceedings argued that the interest they had retained under the plan was valueless and therefore did not constitute property. However, this argument did not survive the scrutiny of the US Supreme Court in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988).

105 Dutch Bankruptcy Act, Article 384(4)(b). R. van den Sigtenhorst, in: T&C Insolventierecht, commentaar op art. 384 Fw, observing with regard to the second requirement that it "can hardly be understood in any other way than a repetition of the best interest test concretely for those who object […]." See Rb. Den Haag 23 July 2021, ECLI:NL:RBDHA:2021:8121.

been left open. In a group context, consideration may be given to the total reorganisation value that can be generated or realised as a result of the group plan, which would otherwise be lost. Hence, for the purpose of determining the fairness of distribution, one may consider the total (group) reorganisation value and the *relative* entitlement of the creditor to such reorganisation value. The contribution to a plan by the guarantor's shareholders (new value exception) might also be taken into account.[106] In extreme cases, a holdout behaviour by a guaranteed creditor could be qualified as an abuse of rights.[107] That being said, we should keep in mind that abuse of rights is subject to a narrow interpretation and cannot offer a general solution to the given problem. In any case, the rigid application of the APR at the level of each group member involved in a WHOA plan can make the tool of third-party releases less appealing to enterprise groups. Perhaps, the safest option is to avoid cross-class cram down, if possible. Without it, the APR question does not arise.

10.3 Conclusions and Suggestions

10.3.1 Overview of main findings

Third-party releases are born out of commercial necessity. They synchronise legal responses to business and financing models, addressing the complexity of group interdependences facilitated by intra-group liability arrangements. They ensure a "single point of entry" to the resolution of group crises, thereby saving costs that would otherwise arise from multiple proceedings. But the significance of third-party releases extends far beyond simple cost-saving. It grants the liberating effect of debt alteration or discharge to third (non-debtor) parties. We will refer to this effect as the "extension effect". The economic benefits of a third-party release are clear.

106 N. Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework, OUP, 2018, para. 6.97, observing that under the new value exception, shareholders can retain their investment, "even if dissenting senior classes are not fully satisfied, if in consideration for their retained interest they contribute new funds or new value that is at least equal to the value of their retained interest." For the discussion of new value exception, APR and the position of shareholders, see Rb. Midden-Nederland 31 March 2022, ECLI:NL:RBMNE:2022:1329, r.o. 4.42ff, *JOR* 2022/240, m.nt. R. van den Sigtenhorst, explaining that the possibility to deviate from the APR is that a shareholder may preserve a stake in the debtor if he acquires this stake at market price by contributing new money. Such a contribution must be in reasonable proportion to the value that is obtained or retained. In scrutinising the new money exception and the adequacy of shareholder contribution, the court considered the fact that no other party, including the dissenting creditor, was willing to provide the funds necessary to implement the restructuring.

107 Dutch Civil Code, Article 3:13. See HR 12 August 2005, *NJ* 2006/230 (*Groenemeijer/Payroll*); HR 24 March 2017, *NJ* 2017/466 (*Mondia/V&D*), dealing with the possibility to force one or several creditors to join the agreement proposed by the debtor out of court, where the majority of creditors have already agreed to the agreement, and the holdout creditor's behaviour is regarded an abuse of rights.

It safeguards the continuity of a group enterprise against the destabilising function of cross-guarantees. In the alternative, simultaneous enforcement of cross-entity obligations for the full amount may result in the destruction of enterprise value.

A good example of a case where parallel enforcement of debt pursuant to cross-entity liability arrangements greatly complicated a centralised group restructuring is Oi Brazil, introduced in section 1.1.3. This case featured an integrated cross-border group of companies with a complex centralised financing structure, involving special purpose financing entities in the Netherlands, guarantees extended by the parent and operating companies in Brazil, and intercompany loans. In a case like this, third-party releases – either at the level of operating companies or financing companies – could save costs, prevent conflicting judgments, accelerate group reorganisation, and thereby promote the preservation and maximisation of value.

However, the extension effect does not sit well with the traditional entity-by-entity approach to corporate insolvency. It also interferes with a personal security right, such as a guarantee, that rests on the idea of entity separateness. Thus, it implicates freedom of contract to the extent that it affects the rights of creditors against third parties and the obligations of these third parties. Non-consensual amendment or discharge of creditors' claims is an extraordinary feature of a restructuring or insolvency proceeding. Yet, in the case of a third-party release, these effects are achieved without opening such proceedings with respect to a third party benefiting from the release. Perhaps, this explains why third-party releases are controversial and are treated differently across jurisdictions.

English courts adhere to a pro-release approach and consider third-party releases a common practice in schemes of arrangement. The majority of English schemes deal with financial indebtedness, restructure group obligations, and are approved without any opposition. In contrast, US courts either completely disallow third-party releases, or permit them only in limited and "unusual" circumstances, not restricted to financial or intra-group indebtedness. This negative attitude to third-party releases is driven almost exclusively by their use in mass tort bankruptcies. The Dutch framework for extrajudicial restructuring plans (i.e. WHOA schemes), inspired by the two mentioned legal regimes, tailors third-party releases to resolve financial distress within enterprise groups and provides safeguards to protect affected creditors.

As indicated above, third-party releases may contribute to estate value preservation and maximisation. However, they can also disrupt the protective function of intercompany guarantees and other cross-liability arrangements. Any limitation of rights under these arrangements constitutes an interference with freedom of contract and party autonomy. A release may also interfere with the principle of equal treatment of creditors and non-discrimination if substantive rights of a guaranteed creditor against a guarantor are altered (e.g. reduced or written down) under the plan, while non-guaranteed creditors do not lose such rights, for they never had them in the first place. A guaranteed creditor is treated differently (i.e. less favourably) compared to non-guaranteed creditors. Finally, if, as in the USA, the rules on third-party releases and their application are unpredictable, unclear and non-uniform, the protection of legitimate expectations of creditors is at stake.

The weakening of the protection afforded by intra-group guarantees, co-debtorship and collateral arrangements is likely to negatively affect the amount a guaranteed creditor can receive upon the debtor's default, potentially triggering its own financial distress and insolvency. The economic value of guarantees and other security arrangements is compromised, leading to an increase in the cost of credit and a reduction in the credit available to debtors.[108]

10.3.2 Suggestions on third-party releases in a group context

In pursuit of a balanced solution, the following suggestions can be made regarding third-party releases in a group context.

First, a third-party release should comply with the best-interest-of-creditors test. As we have pointed out in Chapters 3 and 4, this test protects creditor entitlements, promotes substantive fairness, and ensures protection of property rights. We argue that for a guaranteed creditor, this test should be applied with the existence of a claim against a third party in mind. This may necessitate the assessment of what the guaranteed creditor would have received if it were to proceed with a lawsuit against the guarantor, co-debtor or collateral provider. We propose to call this assessment the "group best-interest-of-creditors" test.

Admittedly, the application of the "group best-interest-of-creditors" test might face practical complications and require comprehensive disclosures from a non-debtor seeking to benefit from a release. Nevertheless, these are necessary sacrifices to ensure that a creditor is not deprived of the benefits afforded by a valid and effective personal or proprietary security arrangement. A valid claim against a third party is a property right that should not

108 P.M. Boyle, Non-Debtor Liability In Chapter 11: Validity of Third-Party Discharge In Bankruptcy, Fordham Law Review, Vol. 61, 1992, p. 443, noting that the "availability of the guarantee may reduce the cost of credit because the interest rate on loans will decrease as the risk of default decreases."

be taken away without adequate compensation.[109] This is precisely why a guaranteed creditor should not be worse off under the restructuring plan containing a third-party release, in comparison to an alternative, typically insolvency scenario, wherein the creditor maintains its right to sue the third party. We assert that any other solution risks being disproportionate and would effectively undermine the protective function of the relevant security arrangement. This suggestion aims to safeguard the value of the existing creditor entitlements, promote substantive fairness, and ensure the protection of property rights.

Second, given the diversity of groups, their financial arrangements and crisis situations, it is impossible to come up with a simple bullet-proof and universal formula that would determine whether a third-party release is desirable or justified. Instead, we identify circumstances where the case for third-party releases is strong, and where it is weak.

The case for approving a third-party release is stronger when:

- A third-party release is consensual. If the creditor consents to a release, a third-party release should not raise any objections. It is in line with party autonomy and per se does not negatively affect the insolvency estate or the rights of other creditors.
- A third-party release relates to a derivative claim – a claim that belongs to the debtor and is not an independent claim of the creditor. Claims under cross-guarantees, co-debtorship and other intra-group liability arrangements do not qualify as derivative claims, as they belong to a guaranteed creditor and not the debtor.
- A third party, such as a surety or guarantor, can file a recourse claim (e.g. indemnity or *regres*) in the full amount against the debtor, potentially undermining the success of its restructuring efforts. This is what we call the "ricochet problem", described in Chapter 6. If not addressed, this problem can lead to a failed restructuring and reduced estate value.
- A third-party release is a constituent part of a purely financial restructuring involving sophisticated parties. Well-informed, sophisticated and strongly adjusting creditors are better positioned to diversify their risks and be advised by professional advisors. As a result, any conflicts between weak and strong creditors are less likely to occur, making concerns about the fairness and foreseeability of a third-party release in a purely financial restructuring less salient.

109 J.L. Schroeder, D.G. Carlson, Third Party Releases Under the Bankruptcy Code After Purdue Pharma, American Bankruptcy Institute Law Review, Vol. 31, 2023, p. 3, arguing that a release of creditors' claims against third parties "constitutes an expropriation of property owned by individual creditors." The authors refer to reorganisation plans that contain this type of releases, and which do not provide for adequate compensation, as "theft plans".

- An enterprise group is integrated, and the likely failure of a third party resulting from the enforcement of a guarantee will have a significant detrimental effect on the debtor's own survival. This is the case where the group member benefitting from a release plays an important role within the anchor debtor's group of companies or is an integral part of the anchor debtor's restructuring. Any failure to address this may lead to the "orphan restructuring problem", described in Chapter 6. In essence, the orphan restructuring problem harms the principle of estate value preservation and maximisation (as applied to a group context, see section 4.4.1.), which this suggestion seeks to promote.
- A third-party release is necessary to facilitate efficient, speedy, and cost-effective group restructuring. It can be a useful strategy, especially when dealing with an international enterprise group, like Oi Brazil, where the opening of multiple proceedings against its members in different countries significantly complicates a centralised group solution, leading to excessive costs, substantial delays, holdout behaviour and even conflicting judgments.

By contrast, the need for a third-party release may be called into question when:

- None of the elements mentioned above are present.
- A third party is not financially distressed and does not become financially distressed as a result of the enforcement of the guarantee or collateral. If the third party is solvent and liquid and can pay the debt without getting insolvent or illiquid, the case for a third-party release is weaker. Discharging the liability of a guarantor, co-debtor or collateral provider solely because the principal or scheme debtor is in financial distress and unable to satisfy the creditor's claim in full is difficult to justify in principle. Interference with contractual rights is hard to substantiate if the guarantor, co-debtor, or collateral provider is not experiencing financial distress or insolvency. In such a case, the protection of legitimate expectations, freedom of contract and party autonomy should prevail.
- The case entails a piecemeal liquidation and does not pursue business preservation, regardless of whether the liquidation is achieved via a Chapter 11 plan or WHOA plan. In a piecemeal liquidation scenario, the need to preserve the debtor's going concern value is absent, and therefore, a third-party release – being first and foremost a restructuring tool aimed at business preservation – is less necessary. It is important to note that business preservation does not necessarily require the preservation of business within current companies and could be achieved through a business sale.

Third, the strict application of certain national rules can create roadblocks to the efficient use of third-party releases. We discussed some of them in the above sections on WHOA schemes and demonstrated that the scope of these rules might not allow third-party releases when the guarantors are not a part of the debtor's group or when they provide separate guarantees securing debts of each other. Other potential problems relate to the conditions for third-party releases, such as the requirements to have at least one supporting class of creditors and adhere to the APR for every group entity involved (including released entities). If both requirements must be satisfied with respect to a third party, whose obligations are being subject to the amendment or release, a class of guaranteed creditors, in fact, acquires a veto right. This outcome can make third-party releases less practical or even unworkable outside consensual plans. The need for law to be applied in a commercially sensible way, particularly in financial restructuring cases, in our view, justifies a flexible application of certain rules and special consideration given to group reorganisation value. However, the key safeguard of the group best-interest-of-creditors-test should remain in full force.