The Good, the Bad and the Ugly: Confirmation Standards

Stephen D. Lerner, Moderator
Squire Patton Boggs; Cincinnati

Hon. Kevin J. Carey
U.S. Bankruptcy Court (D. Del.); Wilmington

David M. LeMay
Chadbourne & Parke LLP; New York

Kim Martin Lewis
Dinsmore & Shohl LLP; Cincinnati

Recent Developments in the Interpretation and Application of § 1129(a)(10)

David LeMay
Chadbourne & Parke LLP, New York, NY

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Section 1129(a)(10) of the Bankruptcy Code prohibits a court from confirming a plan of reorganization when "a class of claims is impaired under the plan, [unless] at least one class of claims that is impaired under the plan has accepted the plan." In cases involving multiple debtors within large, complex corporate structures but only one joint plan, this gives rise to an important question: is the requirement that there be one accepting class somewhere within the corporate family? Or is the requirement much stricter: that there must be one accepting class of creditors *of each debtor entity*?

I. The Rise and Fall of the per-Plan approach

A. The first decision to explicitly adopt a per-Plan approach in a case that did not involve substantive consolidation of the Debtors' corporate structure was *In re SGPA, Inc.*, 2001 Bankr. LEXIS 2291 (Bankr. M.D. Pa. September 28, 2001).

1. The *SPGA* court noted that the issue had not come up in prior decisions because otherwise confirmable plans had almost never been proposed in violation of the per-Debtor reading. *Id.* at *14. The only direct discussion prior to *SPGA* of whether such a requirement actually existed came from two cases before Judge Walrath in the District of Delaware, who had discussed without relying on the per-Debtor reading. *Id.*

2. The *SPGA* court disagreed, and while "not pretend[ing] to fully understand the corporate structure of the[] Debtors before or after the reorganization," the court found that substantive consolidation was not necessary to confirm a joint plan, on the per-Plan theory. *SPGA* at *21. The court found that "[t]here is one plan of reorganization. While it is true that various corporations are affected by the Plan, the business of the Debtors remains the same. Whether these Debtors were substantively consolidated or jointly administered would have no adverse effect on the [objecting creditors]."

B. The next decision to explicitly adopt a per-Plan approach was Judge Gonzalez's confirmation order in *In re Enron Corp.*, 01-016034, 2004 Bankr. LEXIS 2549 (Bankr. S.D.N.Y. Jul. 15, 2004). The court in *Enron* provided three rationales for allowing confirmation of a plan even though 96 of the 177 Debtor entities lacked an accepting impaired class. Although the *Enron* decision was marked "not for publication," it is frequently cited by parties and courts advocating the per-Plan approach. *E.g.*, *In re Station Casinos, Inc.*, BK-09-52477, Bankr. LEXIS 5380, at *82 (Bankr. D. Nev. Aug. 27, 2010).

1. First, the *Enron* court cited *SPGA*, noting that the plain language only required one "class of claims that is impaired under the plan." In speaking approvingly of *SPGA*, the *Enron* court also noted that the "inherent fundamental policy behind section 1129(a)(10) . . . provides that an affirmative vote of one impaired class under a plan is sufficient to satisfy section 1129(a)(10) . . . ." *Id.* at *235.

2. Second, *Enron* suggested that courts' confirmation of plans involving "deemed consolidations" (where the Plan contemplates consolidated treatment of all Debtor entities for voting and distribution purposes) reflected their approval of a per-Plan standard. *Id.* at *235. In other words, if a plan can permit consolidation *by its terms*,

then it must be possible for it to be confirmed over the objection of those harmed by that consolidation. *Id.* at *236, citing *In re Genesis Health Ventures, Inc.*, 266 B.R. 591, 619 as such a case. But *Genesis* approved a plan involving deemed consolidation only on a finding that the requirements for substantive consolidation were met. *Id.* at 618.

3. Finally, while there was not substantive consolidation *per se* in *Enron*, the Plan reflected a global compromise that involved *settlement* of substantive consolidation claims. The court found that this cut in favor of allowing a per-Plan approach to confirmation, citing *In re Resorts Int'l*, 145 B.R. 412 (Bankr. D.N.J. 1990), which approved a plan under similar circumstances. *Id.* at 479; *Enron* at *236. The court also found that, even if it were to adopt the per-Debtor reading of 1129(a)(10), it could achieve the same result by confirming the plan with respect to each debtor entity that had an accepting creditor and then approving the global compromise with respect to the others. *Id.*

C. A third significant decision to adopt the per-Plan standard was *JP Morgan Chase Bank, N.A. v. Charter Commc'n Operating, LLC (In re Charter Commc'n)*, 419 B.R. 221 (Bankr. S.D.N.Y. 2009). An objecting creditor alleged the Debtors had gerrymandered accepting classes at each Debtor entity, and that those classes were therefore insufficient to satisfy § 1129(a)(10). The court found that no gerrymandering had taken place, and that the classes involved were in fact impaired. *Id.* at 265-66. The court also cited *Enron* and *SPGA* to support an alternative holding that where "the business of [the Debtors] is managed . . . on an integrated basis[,]" a per-Plan reading of § 1129(a)(10) is appropriate. *Id.* at 267.

II. *Tribune* and the Return of the "Per-Debtor" Approach

SPGA had the alternate ground for its holding that the objecting creditors were not affected by their inability to resist cramdown. *Enron* had the alternate holding that a per-Plan approach is permissible when substantive consolidation claims have been settled. *Charter* only reached the § 1129(a)(10) issue as an alternative to its primary holding that the accepting creditors were not artificially impaired. In *In re Tribune Co.*, 464 B.R. 126 (Bankr. D. Del. 2011), a court was required for the first time to rule squarely on the per plan/per Debtor issue without the aid of an alternative ground for its holding.

A. Referring to the rules of construction in section 102(7), the court held that "the fact that § 1129(a)(10) refers to 'plan' in the singular is not a basis, alone, upon which to conclude that, in a multiple debtor case, only one debtor – or any number fewer than all debtors – must satisfy this standard[,]" and that "each joint plan actually consists of a separate plan for each Debtor." *Id.* at 182.

B. The court also found that the per-Debtor approach was necessitated by comparison to other paragraphs of § 1129(a). Regarding § 1129(a)(3), it asked: "Could . . . these requirements [that a plan be proposed in good faith and not by any means forbidden by law] be met if only one or more - - but fewer than all - - debtors proposing a joint plan satisfies them? The answer is no." *Id.* at 183.

C. Finally, the court addressed the practical effects of a per-Debtor or per-Plan approach. Recognizing that "large, complex, multiple-debtor chapter 11 proceedings are often jointly administered for the convenience of the parties and the court," and noting that many cases reach an agreement that *looks* like consolidation without objection, the court nevertheless held that a per-Debtor reading was required. *Id.* at 183. ("[C]onvenience alone is not sufficient reason to disturb the rights of impaired classes of creditors of a debtor not meeting confirmation standards. . . . [A]bsent substantive consolidation or consent, [§ 1129(a)(10)] must be satisfied by each debtor in a joint plan.").

III. The Strategic Impact of § 1129(a)(10)

A. The choice between a narrow and broad reading of § 1129(a)(10) can make all the difference for the confirmability of a plan and the outcome of a bankruptcy. The per-Debtor approach limits the ability of narrow constituencies to push their own plans through, but it can also increase their power as holdouts if they hold a blocking voting position in each impaired class at one or more debtors whose inclusion is necessary for a joint plan to work.

B. Examining what such constituencies can do under a per-Plan approach will best illustrate these limitations.

1. The case that best illustrates this dynamic is *Tribune* itself, where two plans were competing: the "DCL Plan," proposed by the Debtors, the Committee, and certain senior lenders, and the "Noteholder Plan," proposed by creditors who had purchased notes outstanding from before an earlier leveraged buyout of the Debtor. *Tribune*, 464 B.R. at 135.

2. At the heart of the *Tribune* case were fraudulent transfer claims arising from that LBO. *Id.* at 142. The Noteholder Plan was premised on prosecuting these causes of action "vigorously." *Id.* at 136. The DCL Plan revolved around a proposed settlement of those claims, aiming at a prompt, certain distribution for the creditors of all entities throughout the corporate structure. *Id.*

3. The Noteholder Plan met with massive disapproval from most constituencies in the bankruptcy. *Id.* at 180 ("The Noteholder Plan . . . received the affirmative support of only *three* out of 256 impaired classes, yielding an accepting impaired class at only *two* out of the 111 Debtors.").

4. Under a per-Plan approach, however, the Noteholder Plan would likely have been potentially confirmable. So long as it met the cramdown requirements of § 1129(b), and subject in that case to selection by the court as the "winning" plan under § 1129(c), all that would be necessary for confirmation under a per-Plan approach would be that at least one class of creditors, somewhere in the corporate structure, thought that taking a gamble on protracted fraudulent conveyance litigation would be worth it.

C. The per-Debtor approach inhibits narrow constituencies from confirming otherwise-unpopular plans after the exclusivity periods have expired.

D. On the other hand, the per-Debtor approach also potentially magnifies the blocking power of narrow constituencies.

1. In the *Tribune* case, the court found that the DCL Plan, as originally submitted, *also* was not confirmable. This was not the result of widespread antipathy, but narrow apathy. *Id.* at 180, 184. Even though the DCL Plan was "accepted by an impaired class at every Debtor *for which votes were cast*," *id.* at 180 (emphasis added), the court found that that was insufficient. Because there were Debtor entities whose creditors had not voted at all, the DCL Plan could not be confirmed in its original form. But in *Tribune*, the entities at which no votes were cast were economically insignificant corporate shells with no meaningful assets or liabilities, so their inclusion in the DCL Plan was not essential.

2. The court suggested limited resolicitation with an "explicit and well advertised" "deemed acceptance" term in the plan and disclosure statement, providing that every class that does not submit a vote for the plan will be deemed to accept it. *Id.* at 184, citing *In re Adelphia Commc'ns Corp.*, 368 B.R. 140 (Bankr. S.D.N.Y. 2007). The court explicitly found that such a "deemed acceptance" provision would constitute the necessary consent to such a scheme. *Tribune*, 464 B.R. at 183. That course was feasible for the DCL Plan because the relevant debtors were empty shells. *In re Tribune Co.*, 476 B.R. 843, 851 (confirming an amended and resolicited version of the DCL Plan).

3. In the alternative, the court suggested that the proponents of a plan that is held up by its inability to get acceptance at certain debtors could "drop from a proposed joint plan those debtors that . . . cannot meet the §1129(a)(10) requirement." *Id.* at 184.

4. One extreme example of the difficulties inherent in the per-Debtor approach can be seen in *In re JER/Jameson Mezz Borrower II, LLC*, 61 B.R. 293 (Bankr. D. Del. 2011). The Debtor ("Mezz II") was part of a corporate structure (the "Mezzanine Borrowers") designed for the purpose of allowing hotel operating companies to borrow additional funds. *Id.* at 295. The operating companies were wholly owned by a company known as Mezz I, which was wholly owned by Mezz II, and so on up to Mezz IV. None of the Mezzanine Borrowers had any other assets. *Id.* at 295.

a. When the loans to Mezzes I-IV all became delinquent, the lender to Mezz II ("Colony") began competing with a group of lenders to Mezz III and Mezz IV ("Gramercy") to obtain the value of the operating companies. *Id.* at 296. In an effort to get the companies back on their feet, Mezzes I-IV, together with the operating companies, filed voluntary petitions.

b. Colony moved to dismiss the petition, on the grounds that the bankruptcy was a litigation tactic intended to keep it from foreclosing on Mezz I, which secured its loan to Mezz II. *Id.* at 300. The court rejected that contention, refusing to ignore Mezz II's status as part of a larger enterprise and finding that the purpose of the filing was to rehabilitate the operating companies. *Id.* at 301.

c. Despite finding that the filing was in good faith, Judge Walrath still determined that she had to dismiss the petitions. While the bankruptcy was a good faith effort to rehabilitate the Debtors, it would have been completely impossible, in light of *Tribune*, for the Debtors to confirm a plan. *Id.* at 302-03 ("[T]o confirm a plan, Mezz II would need to have at least one impaired, accepting class. . . . Mezz II has only one creditor and one asset. Mezz II cannot confirm a plan over Colony's objection because it could get no accepting class.").

5. The result of this holdout power may be that many companies just do not get rehabilitated in chapter 11. If one Debtor entity has only a single impaired creditor, that creditor holds complete sway over the course of its bankruptcy, because its say-so is enough to veto a plan. If that creditor holds claims or interests against other Debtor entities, its disproportionate influence can make it impossible for anyone to propose a joint plan for the entire corporate group that satisfies both it and other creditors.

a. But as the court noted in *Tribune*, dropping some Debtor entities from a joint plan, or from bankruptcy entirely, is not always a bad idea. *Tribune*, 464 B.R. at 184.

b. If a creditor like Colony, for instance, were to foreclose on Mezz II's single asset (Mezz I) after dismissal of the case, nothing would prevent it from putting the operating companies back in bankruptcy and rehabilitating them, if it thought that a bankruptcy was still necessary after casting off the structurally-subordinate creditors.

6. Permitting this sort of clean break both validates prepetition decisions about priority and permits the orderly reorganization of operating companies free of intentionally subordinated creditor influences. Gramercy or its equivalent would be left holding worthless shell companies, but that is exactly what it bargained for by lending to a structurally-subordinate borrower.

IV. Recent Developments

The Ninth Circuit may have revived the issue in September, determining that an appeal of the *Transwest* case, in which the court had adopted the per-Plan approach over a creditor's objection, was not equitably moot. The Ninth Circuit remanded the case to the District Court for the District of Arizona to hear the appeal on the merits in the first instance. *Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)*, 801 F.3d 1161 (9th Cir. 2015). Initial briefing to the District Court in that case is supposed to be completed by late March, with oral argument to be held on May 16th. Orders 107 & 109, *Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)* (D. Ariz. 2016) (4:12-cv-00024-RCC).

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Releases and Exculpations
When the Unusual Becomes Commonplace

Kim Martin Lewis
Dinsmore & Shohl, LLP, Cincinnati, Ohio

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Every constituency that touches a plan of reorganization in the negotiation process wants to be released from any claims related to their activities with the Debtor. They also want their officers, directors, affiliates, employees, and professionals to be released. In addition to the release for past activities, they want exculpation for the negotiation, implementation, and administration of the plan of reorganization. And they all want a release from everyone, including the Debtors, Reorganized Debtor, lenders, unsecured creditors, equity holders, plan sponsors, and others.

While everyone wants a release, not everyone wants to provide a release. In some cases, creditor constituents or equity holders believe their only source of meaningful recovery is from the lenders or the officers and directors, or another released party. As a result, the releases contained within plans of reorganization are often ripe for objection as being overly broad and exceeding the limitations imposed by the Bankruptcy Code. The number of controversies involving releases continues to increase due to the nature of release clauses, the split in circuits on the viability of certain releases in the first instance, and the fact specific analysis courts undertake to evaluate whether specific releases are proper. This has led to significant case law, and the body of law on the subject continues to grow.

There are a couple main types of releases that appear in case law. The first, generally less controversial, is releases of third parties by the Debtors. While most courts permit the Debtor to release third parties under a plan of reorganization, at least one recent case discusses the limitations that exist with respect to releases by the Debtor of third parties. The more common controversy involves non-consensual releases of non-debtors. There is a circuit split as to whether non-consensual releases of non-debtors by third parties are proper in the first instance. In the majority courts, where they can be used, there is further dispute on how broadly such releases can be utilized, what constitutes consent, and whether it is necessary to opt-in to releases as opposed to being presumed to release non-debtors unless affirmatively opting-out.

1. Debtor Releases and Washington Mutual

While generally less controversial, the 2011 decision by the Bankruptcy Court for the District of Delaware in *In re Washington Mutual, Inc*., 442 B.R. 314 (Bankr. D. Del. 2011) had a lengthy discussion and analysis of the debtor releases contained within the proposed plan of reorganization.

Under the terms of the plan, the Debtors were to provide releases to certain parties that participated in a global settlement clearing the way for a plan of reorganization, including the FDIC, along with the creditors' committee, certain noteholders that participated in the settlement, officers, directors, and other professionals of the released parties, and other affiliates.

The bankruptcy court identified a five factor evaluation that provided neither exclusive nor conjunctive requirements, but simply provided guidance to determine the fairness of the releases by the Debtors. The five factors were:

(1) an identity of interest between the debtor and non-debtor such that a suit against the non-debtor will deplete the estate's resources;
(2) a substantial contribution to the plan by the non-debtor;
(3) the necessity of the release to the reorganization;
(4) the overwhelming acceptance of the plan and release by creditors and interest holders; and
(5) the payment of all or substantially all of the claims of the creditors and interest holders under the plan.

Id. at 346 (citing *In re Zenith Elecs*. *Corp*., 241 B.R. 92, 110 (Bankr. D. Del. 1999); *In re Master Mortgage Inv*. *Fund, Inc*., 168 B.R. 930, 937 (Bankr. W.D. Mo. 1994).

In evaluating the factors against the facts of the case, the court evaluated the different parties being released against the factors. The plan proponents and parties contributing substantially to the settlement and plan were permitted their releases. However, the releases to the creditors' committee, officers, directors, and other professionals, and other affiliates were deemed not to satisfy the test and the releases were not granted.

The court did note that while the releases to the committee were not appropriate, the committee was entitled to exculpation for the role they played in the process. The court noted that, as a fiduciary of the estate, the exculpation clause that protects the committee and its members from liability for their actions in the case, except in cases of willful misconduct or gross negligence was appropriate. However, the protections of the exculpation were limited to the parties that are fiduciaries of the estate, including the creditors' committee, debtor, and officers and directors of the debtor.

2. Non-Consensual Releases of Non-Debtors

The more typical objection to releases derives from the release of non-debtors by other non-debtors. While consensual releases are generally approved, certain circumstances give rise to efforts to obtain releases non-consensually. This occurs either because a non-debtor does not have the opportunity to opt-in/opt-out of the releases or fails to respond when given an opportunity.

The majority of courts hold that non-consensual releases of non-debtors are permitted under certain limited circumstances. As shown in the cases below, it is a fact-intensive analysis. Where permitted, there is a further analysis on what constitutes 'consent' and whether a party can be deemed to consent because they did not take affirmative action to opt-out of the releases or because they were deemed unimpaired under the plan and therefore not entitled to vote.

A minority of courts hold, however, that non-consensual releases are not permitted under section 524(e) of the Bankruptcy Code.

A. The Minority Position – Section 524(e) Prohibits Non-Consensual Releases of Non-Debtor Parties

The Fifth, Ninth, and Tenth Circuits follow the minority position that refuse to allow non-debtor releases under section 524(e) of the Bankruptcy Code, which provides that "discharge of a debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." An illustrative case applying this analysis is *In re The Pacific Lumber Co*., 584 F.3d 229 (5th Cir. 2009).

In *Pacific Lumber*, the Indenture Trustee and certain noteholders appealed confirmation of a plan that was crammed down on them. Among other issues, they asserted that the release of the plan proponents, Reorganized Debtor, and Creditors' Committee, among others, was inappropriate. The Released Parties were being released from liability, except for willfulness or gross negligence, related to proposing, implementing, and administering the plan.

The court cited to section 524(g) of the Bankruptcy Code, which enjoins third party claims under certain circumstances, and channels such claims to a specific pool of assets in support of its proposition that other non-consensual releases were not permitted by the Code. The court then looked to 524(e) to note that the Bankruptcy Code does not permit the release of parties from any negligent conduct that occurred during the bankruptcy case.

B. The Majority Position – Non-Consensual Releases of Non-Debtor's Are Authorized Under Unique Circumstances

The Second, Third, Fourth, Sixth, Seventh, and most recently Eleventh Circuits have authorized non-consensual releases of non-debtors, at least under certain limited circumstances.

In March 2015, the Eleventh Circuit joined the majority of courts in *In re Seaside Engineering & Surveying, Inc*., 780 F.3d. 1070 (11th Cir. 2015). In *Seaside*, the Debtors and others engaged in a lengthy battle that the court described as a "death struggle" before reaching a settlement that involved non-consensual, non-debtor releases.

On appeal, the Eleventh Circuit evaluated the circuit split, noting that they "respectfully disagree with the position of the minority circuits with respect to §524(e)," finding that the "natural reading of this provision does not foreclose a third-party release from a creditor's claim." *Id*. at 1078. They then relied upon the equitable nature of the court and §105(a) for the view that non-consensual, non-debtor releases may be appropriate in "unusual cases in which such an order is necessary for the success of the reorganization, and only in situations in which such an order is fair and equitable under all the facts and circumstances. The inquiry is fact intensive in the extreme." *Id* at 1078-79.

In evaluating the facts, the Eleventh Circuit looked to the Sixth Circuit Dow Corning factors, which include:

(1) An identity of interests between the debtor and the third party, usually an indemnity relationship;
(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 could have indemnity or contribution claims against the debtor;
(4) The impacted class, or classes, overwhelmingly supporting 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 factual findings that support its conclusion

Id. at 1079. The Eleventh Circuit, like other circuits, stressed that the list is non-exclusive and should be applied flexibly, keeping in mind that such releases should be used cautiously, infrequently, and in unusual circumstances, where essential to the reorganization and fair and equitable to the parties. Based on the facts at issue in *Seaside*, where the releases were essential to a conclusion of the bankruptcy and protected the reorganized debtor from potential substantial risk in its ability for long-term success, the Eleventh Circuit approved the releases.

C. Other Recent Cases and Issues In Non-Consensual Non-Debtor Releases

In the last couple years, there have been two new cases that addressed continuing controversies involving non-consensual, third-party releases; *In re Genco Shipping & Trading Limited*, 513 B.R. 233 (Bankr. S.D.N.Y. 2014); *In re Chassix Holdings, Inc*., 533 B.R. 64 (Bankr. S.D.N.Y. 2015).

(i) *Genco Shipping*

In *Genco Shipping*, an Official Committee of Equity Holders objected to a proposed plan, both for the valuation of the Debtors and for the releases provided to non-debtors. The releases were fairly standard broad releases of the Debtors, Reorganized Debtors, various participating lenders, noteholders, and directors, officers, affiliates, and advisors.

As with other cases addressing non-consensual, non-debtor releases, the court noted that such releases and exculpations are not routine matters and reserved for unique circumstances. *In re Genco Shipping & Trading Limited*, 513 B.R. at 269.

The specific issue before the court was the release by the equity holders, who were deemed unimpaired under the plan, and therefore not entitled to vote. The United States Trustee and Equity Committee argued that they were not, in fact, unimpaired, if they released claims they may have against certain non-debtor parties.

While the court did not directly address the impairment of a class of creditors or interest holders when they were deemed to release non-debtor parties, they did evaluate the scope of the releases in the plan as they related to non-consenting parties. The court looked to the Second Circuit test under *In re Metromedia Fiber Network, Inc*., 416 F.3d 136, 141 (2d Cir. 2005) to evaluate whether the non-debtor releases were appropriate, notwithstanding the identification of the equity holders as unimpaired. Under the *Metromendia* test, the releases may be appropriate where they are important to the debtor's plan, are channeled to a settlement fund rather than extinguished, the enjoined claims would indirectly impact the debtor's reorganization by way of indemnity or contribution, the released party provides substantial consideration, and the plan otherwise provides for the full payment of the enjoined class. *In re Genco Shipping & Trading Limited*, 513 B.R. at 269.

Under this test, the court allowed the releases for non-debtor parties that, by virtue of pre-petition employment agreements, bylaws, retentions, or other loan agreements, were entitled to indemnification or contribution by the Debtors. It did not extend the releases to parties who received an indemnification from the Debtors during the bankruptcy process, including as a result of a support agreement or through inclusion in the proposed plan. Finally, the court approved releases where there was substantial consideration made by non-debtor parties, either through concessions on existing debt, conversion of debt to equity, or payment of other consideration.

(ii) *Chassix Holdings*

In July 2015, the Bankruptcy Court for the Southern District of New York published another opinion addressing non-consensual, non-debtor releases in *In re Chassix Holdings, Inc*., 533 B.R. 64 (Bankr. S.D.N.Y. July 9, 2015).

In *Chassix Holdings*, the court quickly overruled the only filed objection to the releases , noting that the releases did not apply to the objector who voted against the plan and opted out of the releases in question. However, the court "on its own initiative" restricted the scope of the releases contained in the plan and their application to certain creditors. *Id*. at 77. Specifically, the court raised concerns with the manner in which the ballot required affirmative action to opt-out of releases and did not require affirmative action to opt-in. The result of the opt-out provision was that parties that did not return ballots or take affirmative action were deemed to opt-in and be bound by the releases contained within the plan.

The court noted that third party releases should only be approved in unusual circumstances and not as a matter of course in plans of reorganization. Given the preference against non-debtor releases, the court questioned a format that expanded the number of parties giving releases through "deemed consent." The court noted that "many creditors and interest holders who receive disclosure statements and solicitation materials simply will not respond to them" and therefore, noted consent to releases is a "legal fiction." *Id*. at 78.

One particularly troubling aspect for the Chassix court was a "death trap" provision in the plan that provided that unsecured creditors would be at risk of not receiving any recoveries if the class did not support the plan. However, an affirmative vote for the plan by an individual claimant was also an affirmative vote on the releases contained within the plan. Therefore, there was a risk (that didn't materialize) that individual parties would vote for the plan and grant non-debtor releases, but then not receive a recovery as a result of the class ultimately voting down the plan. *Id*. at 79.

Ultimately, the court held that, under the unique facts of this case, "it would be inappropriate to treat . . . inaction as a 'consent' to third party releases." *Id*. at 80. The result limited the scope of the releases to those creditors and other parties that objectively, opted in to the release, either through voting for the plan (and not-opting out) or who voted against the plan but opted in to the release. Finally, the court noted that if a party releases non-debtor's under a plan, they cannot truly be unimpaired. Therefore, parties that are deemed unimpaired under the plan should not be deemed to have consented to the third party releases set forth in the plan. *Id*. at 81.

D. Coming Attractions? In re Millenium Lab Holdings II, LLC, 2016 Bankr. Lexis 116

On January 12, 2016, the Bankruptcy Court for the District of Delaware certified for direct appeal to the Third Circuit the issue of non-consensual third party releases. In *Millenium Lab Holdings*, the Bankruptcy Court approved a plan that contained non-debtor releases over the objection of certain objecting lenders. The certification for direct appeal was premised on a perceived conflict among the courts in the circuit.

In approving the releases, the Bankruptcy Court looked to *Gillman v*. *Continental Airlines (In re Continental Airlines*), 203 F.3d 203 (3d Cir. 2000), which the court believed controlled the issue. In *Continental Airlines*, the Third Circuit evaluated the releases in questions based upon "the hallmarks of permissible nonconsensual releases – fairness, necessity to the reorganization, and specific factual findings to support these conclusions." *Id*. at 214. While the Third Circuit did not approve the releases in *Continental Airlines*, the reference to hallmarks of permissible releases supports the conclusion that, by inference, certain non-consensual releases are appropriate.

Conversely, among other cases, the objecting lenders relied on *In re Washington Mutual, Inc*., 442 B.R. 314 (Bankr. D. Del.) for the proposition that a conflict within the circuit exists. In its discussion of non-consensual non-debtor releases, the *Washington Mutual* Court noted that "[w]hile the Third Circuit has not barred third party releases, it has recognized that they are the exception, not the rule." *Id*. at 351. Further, the Bankruptcy Court went on to find that "[t]his Court has previously held that it does not have the power to grant a third party release of a non-debtor." *Id*. at 352.

Based upon the conflicting case law within the Third Circuit, the Millenium Lab Court certified the issue of non-consensual non-debtor releases for direct appeal to the Third Circuit Court of Appeals. The Petition for Permission for Direct Appeal was filed with the Third Circuit in early February.

Recent Developments in Equitable Mootness

David LeMay
Chadbourne & Parke LLP, New York, NY

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Equitable mootness is a judge-made doctrine that applies only in bankruptcy appeals. It allows appellate courts to dismiss an appeal of a confirmed plan of reorganization as "equitably moot" if, under the particular circumstances of a case, granting the requested relief would be inequitable. Because equitable mootness allows for dismissal of an appeal without consideration of the merits, it has been the subject of some debate at the circuit court level. Although the doctrine of equitable mootness has been recognized and applied by all of the circuit courts except the Federal Circuit (which does not hear bankruptcy appeals), doubts remain in the minds of some judges as to whether the doctrine should continue to be applied.

I. The Second Circuit's Broad Approach

A. Presumption of Equitable Mootness

1. In the Second Circuit, a bankruptcy appeal is presumed equitably moot when the debtor's reorganization plan has been substantially consummated. *FritoLay, Inc. v. LTV Steel Co.* (*In re Chateaugay Corp*.), 10 F.3d 944 (2d Cir. 1993)

a. "Substantial consummation," as defined by section 1101(2) of the Bankruptcy Code, requires "(A) transfer of all or substantially all of the property proposed by the plan to be transferred; (B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and (C) commencement of distribution under the plan." 11 U.S.C. § 1101(2).

b. In most circumstances, "substantial consummation" as defined in the Bankruptcy Code will occur upon the effective date of the plan of reorganization.

2. This presumption of equitable mootness places the burden on the appellant to rebut the presumption in order to continue the appeal. *See, e.g.*, *Aetna Cas. & Sur. Co. v. LTV Steel Co*. (*In re Chateaugay Corp*.), 94 F.3d 772, 776 (2d Cir. 1996).

3. The presumption of equitable mootness created by a plan's substantial consummation can be overcome by an objector if the following five factors are satisfied: (1) the court can still order some effective relief; (2) such relief will not affect the re-emergence of the debtor as a revitalized corporate entity; (3) such relief will not unravel intricate transactions so as to knock the props out from under the authorization for every transaction that has taken place and create an unmanageable, uncontrollable situation for the Bankruptcy Court; (4) the parties who would be adversely affected by the modification have notice of the appeal and an opportunity to participate in the proceedings; and (5) the appellant pursued with diligence all available remedies to obtain a stay of execution of the objectionable order, if the failure to do so creates a situation rendering it inequitable to reverse the orders appealed from. *See Chateaugay*, 10 F.3d at 952-53.

B. The Broad Reach of Equitable Mootness in the Second Circuit

1. The Second Circuit recently reiterated its approach to equitable mootness, and extended the doctrine to reach chapter 11 liquidation proceedings. *See Beeman v. BGI Creditors' Liquidating Trust (In re BGI, Inc.)*, 772 F.3d 102, 108-09 (2d Cir. 2014).

2. The court in *BGI* observed: "the doctrine of equitable mootness has already been accorded broad reach, without apparent ill effect." *Id*. at 109.

II. The Third Circuit Keeps a Tight Rein on Equitable Mootness

A. The Third Circuit Urges Caution

1. Although the Third Circuit has long recognized the doctrine of equitable mootness, it urged from the outset that the doctrine should be "limited in scope and cautiously applied." *In re Continental Airlines*, 91 F.3d 553, 559 (3d Cir. 1996) (*en banc*).

2. Although it originally used a five-factor analysis similar to the test used in the Second Circuit, the Third Circuit has since refined its equitable mootness analysis into two analytical steps: (1) whether a confirmed plan has been substantially consummated as per the Bankruptcy Code's definition; and (2) if so, whether granting the relief requested in the appeal would fatally scramble the plan and/or significantly harm third parties who justifiably relied on the confirmed plan. *See, e.g.*, *Samson Energy Res. Co. v. SemCrude L.P.* (*In re SemCrude L.P.*), 728 F.3d 314, 321 (3d Cir. 2013).

3. Unlike the Second Circuit's approach, the Third Circuit's analysis places the burden to prove that an appeal is equitably moot on the party seeking dismissal. *Id*. at 321-22. This approach is consistent with the approaches used in the Ninth, Tenth, and Eleventh Circuits. Placing the burden on the plan proponents makes it more difficult for reorganized companies to cut off appeals of confirmation orders without adjudication on the merits.

3. In three recent cases, the Third Circuit has reemphasized the need for caution in applying equitable mootness, highlighting the judge-made origin of the equitable mootness doctrine and the responsibility of federal courts to exercise their jurisdictional mandate to hear appeals.

a. In the *SemCrude* case, the Third Circuit emphasized that federal courts have a "virtually unflagging obligation" to hear appeals and, therefore, dismissing an appeal on equitable mootness grounds "should be the rare exception." *Id.* at 320-21. Before dismissing an appeal as equitably moot, an appellate court must be almost certain that granting the requested relief would "produce a perverse outcome—chaos in the bankruptcy court from a plan in tatters and/or significant injury to third parties." *Id*. at 320.

i. In *SemCrude*, the reorganized debtors argued that providing any relief to the appellant would have unraveled the entire plan. However,

the Third Circuit found that the appellants simply sought a ruling that the plan did not discharge their specific claims and asked for the opportunity to assert those claims in an adversary proceeding

ii. Because a successful appeal would have impacted less than 0.15% of the distributions under a settlement in the plan ($200,000 out of $160 million), the Third Circuit declined to dismiss the appeal as equitably moot. The Third Circuit noted that the potential for unraveling the plan was purely speculative and, rather than refuse to hear the merits of the appeal at its outset, a court could fashion limited relief at the remedial stage that would present options short of undoing the entire plan.

b. Similarly, in the *One2One Communications* case, the Third Circuit found that the appeal should proceed because, among other things, "the Plan did not involve intricate transactions and the Debtor did not present sufficient evidence that the Plan would be difficult to unravel." *In re One2One Commc'ns, LLC*, 805 F.3d 428, 436 (3d Cir. 2015). The case involved a $200,000 investment in the reorganized debtor and only one secured creditor that held a blanket lien in the debtor's assets for less than $100,000. The debtor had only seventeen non-insider unsecured creditors, and the plan did not provide for new financing or any complex restructuring transactions. The Third Circuit observed that this was not a case in which the debtor had issued publicly traded securities under its plan that third parties were trading on the open market. Accordingly, the Third Circuit remanded the case to the District Court for it to consider the appeal on its merits.

c. The *Tribune* case presented an interesting situation in which the Third Circuit considered whether two separate appeals of the same plan of reorganization were equitably moot. *Aurelius Capital Mgmt., L.P. v. Tribune Media Co.* (*In re Tribune Media Co*.), 799 F.3d 272 (3d. Cir. 2015).

i. The principal appeal of the *Tribune* plan challenged a global settlement that was at the very foundation of the confirmed plan. A reversal of the confirmation order would have required the annulment of that global settlement and the reinstatement of billions of dollars of litigation claims relating to Tribune's 2007 leveraged buy-out. The Third Circuit observed that "returning to the drawing board would at a minimum drastically diminish the value of new equity's investment," which had been made in reliance on the settlement. *Id*. at 281. Therefore, the Third Circuit found that allowing that appeal to proceed, even if the merits of the appeal were valid, would "recall the entire Plan for a redo," and dismissed the appeal as equitably moot. *Id*. Aurelius has filed a petition for a writ of certiorari on the Third Circuit's dismissal of its *Tribune* appeal. That petition is currently pending before the Supreme Court.

ii. A separate appeal of the *Tribune* plan challenged whether the allocation of approximately $30 million to one class of creditors rather than a different class was appropriate. The Third Circuit observed that a

challenge regarding $30 million in the context of a $7.5 billion reorganization would not unravel the plan and that the creditors who had relied (although not "justifiably" in the legal context) on those distributions were easily identifiable. Accordingly, the appeal of the allocation of certain distributions was remanded to the District Court for consideration of the merits. *Id*. at 282-83.

4. In sum, in the Third Circuit, if the issue under appeal is not integral to the foundation of the plan, or if the appellant presents intermediate remedies short of undoing the plan, courts in the Third Circuit will be required to hear confirmation appeals on their merits.

III. The Ninth Circuit Further Limits the Scope of Equitable Mootness

A. Standard Applied in the Ninth Circuit

1. Similar to the Third Circuit, the Ninth Circuit has urged courts to be cautious in applying equitable mootness.

2. The Ninth Circuit has set out four considerations to help determine whether an appeal is equitably moot: (1) whether a stay was sought, for absent that a party has not fully pursued its rights; (2) if a stay was sought and not gained, whether substantial consummation of the plan has occurred; (3) the effect a remedy may have on third parties not before the court; and (4) most importantly, whether the bankruptcy court can fashion effective and equitable relief without completely knocking the props out from under the plan and thereby creating an uncontrollable situation for the bankruptcy court. *See Motor Vehicle Cas. Co. v. Thorpe Insulation Co*. (*In re Thorpe Insulation Co*.), 677 F.3d 869, 881 (9th Cir. 2012).

3. On the question of remedies, the Ninth Circuit stated recently that the task of an appellate court in analyzing whether to dismiss for equitable mootness is to determine whether, if the appeal were to succeed on the merits, an equitable remedy could be fashioned. *See JPMCC 2007-C1 Grasslawn Lodging, LLC v. Transwest Resort Props., Inc. (In re Transwest Resort Props., Inc.)*, 801 F.3d 1161, 1168 (9th Cir. 2015)

4. The Ninth Circuit places great significance on an appellant's attempt to obtain a stay and, indeed, where an appellant has been diligent in seeking a stay, that factor "cuts strongly in favor of appellate review" of the merits of the appellant's claims. *Id*. at 1168.

B. Reliance by "Innocent" Third Parties

1. In the *Transwest* case, the Ninth Circuit refined its analysis of equitable mootness to clarify that the doctrine is intended to protect only "innocent" third parties. *Id*. at 1169. In other words, a party's "involvement in the reorganization process means that it is not the type of innocent third party that the third prong of the equitable mootness test is designed to protect." *Id*. at 1171.

a. In *Transwest*, that meant that the purchaser of the debtor's assets in the bankruptcy case, by virtue of its involvement in the reorganization and its pleadings in support of confirmation, could not argue that its reliance on the finality of the confirmed plan justified dismissal on equitable mootness grounds. *Id*. at 1169-70.

b. The dissenting opinion in *Transwest* expressed a belief that limiting the protection of equitable mootness to innocent third parties "ignores the realities of the marketplace," and that reliance on confirmation orders should be encouraged so that parties remain willing to invest in bankrupt companies. *Id*. at 1174-75 (Smith, J., dissenting). In response, the Ninth Circuit observed that allowing a postpetition investor "to stick to a plan that may violate the Bankruptcy Code" or if it prevented a prepetition Lender from arguing its objections on appeal, it would risk "decreasing potential lenders' incentives to make loans in the first place." *Id*. at 1170 n.11.

IV. Third Circuit Judges Debate Equitable Mootness

A. In 2015, two Third Circuit judges wrote concurrences regarding the constitutionality, statutory foundation, and fairness of equitable mootness.

1. In the *One2One* case, Judge Cheryl Ann Krause entered a concurring opinion suggesting that courts should not persist in "failed attempts to cabin this legally ungrounded and practically unadministrable judge-made abstention doctrine. . . . Rather, the time has come to reconsider whether it should exist at all, and, if we conclude it should, to reform it substantially." *One2One*, 805 F.3d at 438 (Krause, J., concurring). Judge Krause challenged, among other things, whether equitable mootness is constitutional, appropriate under the Bankruptcy Code, and fair to appellants.

2. Judge Thomas L. Ambro, a former Delaware bankruptcy practitioner recognized as one of the leading bankruptcy experts on the Third Circuit, responded to Judge Krause with a concurring opinion (which was joined by Judge Thomas I. Vanaskie) in the *Tribune* case. Judge Ambro's concurrence is noteworthy in its robust defense of the equitable mootness doctrine as an important part of a judge's "equitable toolbox." *Tribune*, 799 F.3d at 288 (Ambro, J., concurring).

B. Constitutionality of Equitable Mootness

1. Judge Krause's concurrence expressed "serious constitutional concerns" that the equitable mootness doctrine results in failure to provide appellate review of bankruptcy judges' decisions by an Article III court, in spite of the acknowledged "virtually unflagging obligation" to do so. *One2One*, 805 F.3d at 446 (Krause, J., concurring). Judge Krause wrote: an appellate court's refusal to hear the merits of a case on equitable mootness grounds "is not abstention; it's abdication." *Id*. at 440. The concurrence noted that the insulation of bankruptcy judges' decision violated (1) a personal right to Article III adjudication, and (2) the structural integrity of the judicial branch. *Id.* at 444.

2. In response, Judge Ambro stressed that equitable mootness is only applied to "a quite constricted class of cases" and only where the relief requested "would upend cases resolved and plans implemented (often years before) and/or would significantly harm third parties who relied on that resolution and implementation." *Tribune*, 799 F.3d at 286 (Ambro, J., concurring). Although the Judge acknowledged that his analysis was perhaps "formalistic," the key point was that the significant harm that might befall parties in bankruptcy appeals presents a unique circumstance that outweighs constitutional concerns. *Id*.

C. Appropriateness Under the Bankruptcy Code

1. Judge Krause's concurrence challenged whether equitable mootness has any basis in law, and concluded that it does not. The concurrence analyzed a number of provisions of the Bankruptcy Code and the federal statutes conferring bankruptcy jurisdiction, including provisions specifying that certain bankruptcy court orders may not be disturbed after consummation (*e.g.*, 11 U.S.C §§ 363(m) and 1127(b)). Judge Krause concluded that, rather than establishing a general "policy" supporting equitable mootness, these provisions weigh against the doctrine: "Because Congress specified certain orders that cannot be disturbed on appeal absent a stay, basic canons of statutory construction compel us to presume that Congress did not intend for other orders to be immune from appeal." *One2One*, 805 F.3d at 443-44 (Krause, J., concurring).

2. Judge Ambro did not state whether he agreed with that statutory analysis, and instead observed that the "simpler" approach starts from the premise that bankruptcy courts are courts of equity and apply the principles and rules of equity jurisprudence. Judge Ambro compared the equitable mootness doctrine to other forms of equitable relief, such as injunctions, and noted that "courts always consider a balance of harms to the parties and the public," and equitable mootness is the manifestation of that principle in the bankruptcy appellate context. *Tribune*, 799 F.3d at 287 (Ambro, J., concurring). Judge Ambro concluded: "[T]he *One2One* concurrence . . . misses the point that [equitable mootness] is in the *equitable* toolbox of judges for that scarce case where the relief sought on appeal from an implemented plan, if granted, would leave the plan in tatters and/or bankruptcy battlefield strewn with too many injured bodies." *Id*. at 288.

D. Fairness to Appellants

1. Finally, the concurrences addressed the question of whether it is unfair as a practical matter to deny appellants relief when a bankruptcy or district court has made an error of law. Judge Ambro acknowledged "the unfairness that might result" where an aggrieved party is deprived of appellate relief even in the face of an erroneous lower court decision. However, that unfairness is only exacted upon appellants in the rare cases where modifying a confirmation order would do significant harm. *Id*. at 288.

2. Judge Ambro observed that, in complex bankruptcies, restoring an estate to the *status quo ante* consummation would not only be difficult, but would often result in "crushing expense to the reorganized entity and its shareholders." *Id*. The Judge hypothesized that, in the absence of the equitable mootness doctrine, no complex plan

would be consummated (and no equity investor would put money into a reorganized entity) until all appeals were terminated. (This reasoning was adopted by the dissenting opinion in *Transwest*, discussed above.) That situation would, in Judge Ambro's view, result in dissenting creditors with any plausible sounding argument gaining the ability to hold up emergence from bankruptcy for years "or until such time as other constituents decide to pay the dissenter sufficient settlement consideration to drop the appeal." *Id*. at 288-89.

3. Judge Ambro indicated that he has a favorable view of stays pending appeal conditioned on the posting of supersedeas bonds. Citing to the *Tribune* bankruptcy decision that granted the appellants a stay pending appeal conditioned upon the posting of a bond (which they did not post), Judge Ambro noted the "practical benefit" of the approach and stated that it could effectively balance the conceivable harms to various constituencies, and also shift the burden to the appealing party of determining whether its appeal is "really worth the candle." *Id*. at 289.

Post-Petition Support Agreements: Are They Valid in Light of §1126(e) and What Are Their Limitations?

Kim Martin Lewis
Dinsmore & Shohl LLP, Cincinnati, Ohio

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A Support Agreement is an agreement among the Debtors, various creditor constituencies, and potentially a plan sponsor, which provides a framework for the Debtors' exit from bankruptcy under terms that have been negotiated among the parties. In entering into the Support Agreement, the creditor constituencies typically agree to support a plan of reorganization or sales process that contains the terms set forth in the Support Agreement or attached documents (i.e. a term sheet for a plan of reorganization).

The parties often begin negotiations prior to a bankruptcy filing, and Debtors seek pre-petition support agreements to assist in obtaining financing and obtaining support on an exit strategy that recapitalizes the entity and allows the reorganized debtor to emerge in a timely manner and prepared to succeed in the marketplace.

If the Debtors are unable to reach agreement with the key constituents on the terms of a exit strategy in advance of a filing, it is becoming increasingly common to pursue a post-petition support agreement to lock-in the support of the parties to the terms of a plan of reorganization. Post-petition support agreements have been called into question as a result of section 1125(b) of the Bankruptcy Code, which provides:

> An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information. The court may approve a disclosure statement without a valuation of the debtor or an appraisal of the debtor's assets.

Parties have argued that execution of a post-petition support agreements results from an improper solicitation of votes under section 1125(b), and therefore designation of the non-debtor parties votes is proper under section 1126(e) of the Bankruptcy Code, which provides that, "[o]n request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title."

1. Cases Involving the Designation of Votes:

In 2002, Judge Walrath of the Bankruptcy Court for the District of Delaware designated the votes of parties that executed post-petition lock-up agreements in the cases of *In re Stations Holding Co*., Case No. 02-10882, 2002 Bankr. LEXIS 1617 (Bankr. D. Del. Sept. 30, 2002) and *In re Nii Holdings, Inc*., Case No. 02-11505, 2002 Bankr. LEXIS 2123 (Bankr. D. Del. Oct. 25, 2002).

Neither decision included a detailed overview of the facts or legal analysis. As noted by the *Indianapolis Downs* court (as discussed below), the two cases involved pre-packaged cases

where the parties entered into post-petition lock-up agreements. It was determined the effort to finalize the lock-up agreements constituted a post-petition solicitation of votes on the Plan, prior to the approval of the Disclosure Statement.

2. Indianapolis Downs, Residential Capital and the Emergence of Post-Petition Support Agreements As a Result of Successful Post-Petition Negotiations

A. The first of two 2013 decisions permitting the entry of a post-petition Support Agreement took place in the bankruptcy of Indianapolis Downs, LLC in the District of Delaware. *In re Indianapolis Downs, LLC*, 486 B.R. 286 (Bankr. D. Del. 2013). In *Indianapolis Downs*, the Debtors filed for bankruptcy on April 7, 2011. Months of negotiations followed among the Debtors, Fortress (the holder of substantial second and third lien debt), and an Ad Hoc Committee of Second Lien holders. The result of the negotiations was the Restructuring Support Agreement, dated April 25, 2012 (a year after the Petition Date).

The RSA provided for: (i) a dual track exist strategy that contemplated a market test to determine if there was sufficient interest in an asset sale, with a fallback recapitalization, (ii) milestones for filing a plan of reorganization, (iii) prohibition on any of the parties to the RSA proposing, supporting, or voting for any competing plan of reorganization, and (iv) a requirement that the parties to the RSA vote in favor of a plan that complies with the RSA, enforceable by an order on specific performance.

The Bankruptcy Court approved the Plan and denied a Motion that was brought to designate the votes of the restructuring support parties.

B. The second case was decided five months later, in the Residential Capital, LLC bankruptcy in the Southern District of New York. *In re Residential Capital, LLC*, 2013 Bankr. Lexis 2601 (Bankr. S.D.N.Y. 2013). In *Residential Capital*, the Debtors filed the bankruptcy petition on May 14, 2012. Following a sale of assets that closed in January 2013, the Debtors negotiated with the Creditors' Committee and a number of other parties in interest on the terms of a plan. On May 13, 2013, the parties agreed to terms of the Plan Support Agreement, which included a Plan Term Sheet and Supplemental Term Sheet.

Pursuant to the Plan Support Agreement, the supporting parties agreed to support a Disclosure Statement and Plan containing terms consistent with the PSA and attached Term Sheets and to affirmatively vote in favor of the plan, subject to receipt of an approved Disclosure Statement.

Noting that approval of the Debtors' execution of the PSA is not an approval of the underlying Disclosure Statement or Plan, the Court approved the PSA.

3. Issues for Discussion:

Support agreements are generally the result of negotiation with sophisticated parties that are active in the bankruptcy case and have a significant economic interest in its outcome. In *Indianapolis Downs* and *Residential Capital*, parties that were not party to the support agreements challenged their validity, and sought to designate the votes of those entitled to vote on the plan as a result of the violation of the solicitation clause of section 1125(b) of the Bankruptcy Code and designation clause of section 1126(e) of the Bankruptcy Code. The results of *Indianapolis Downs* and *Residential Capital* and the discussion surrounding the decisions raise a number of questions both as to the legality of post-petition Support Agreements and, to the limitations on the terms and proper manner of drafting both pre- and post-petition support agreements to ensure they stand up to scrutiny.

Are Post-Petition Support Agreements Permitted Under the Bankruptcy Code?

A. Definition of 'Solicitation': The term 'solicitation' is not defined in the Bankruptcy Code. The Courts in *Indianapolis Downs* and *Residential Capital* both found that the definition should be read narrowly, to include the formal polling process on a specific plan. *See also In re Century Globe*, 860 F.2d 94, 100-101 (3rd Cir. 1988) (holding that "solicitation must be read narrowly. A broad reading of § 1125 can seriously inhibit free creditor negotiations"). In doing so, the Courts found that the ability to negotiate with sophisticated parties and to reach resolution in advance of filing a proposed Disclosure Statement and Plan, including the entry into a formal agreement of support, is not 'solicitation' under 1125(b).

How should 'solicitation' be defined and how far can a debtor go to obtain support for a proposed exit strategy? Do the counter-parties need to be sophisticated and represented by competent counsel? Do the counter-parties need to have been involved prior to the bankruptcy filing?

B. True 'Lock-Up' Agreements vs. Support Agreements: Recent Courts have distinguished *Stations Holding* and *Nii Holdings* by noting that those cases forced the non-debtor parties into voting for the Debtors' proposed Plan, thereby stripping the creditors of the protection of 1125(b) and the harm caused by solicitation without a court-approved Disclosure Statement.

The recent cases tend to have termination provisions, and do not obligate a creditor to vote for a Plan unless it complies with the Support Agreement and there is an approved Disclosure Statement.

What is the difference between a true lock-up agreement and a support agreement? Is there any difference? Can parties bind themselves to vote for any Plan with an approved Disclosure Statement?

C. Designation of Votes: Parties challenging the lock-up/support agreements seek to have the votes of the non-debtor parties designated. This was the result in *Stations Holding* and *Nii Holdings*. However, the Western District of Missouri, in *In re Gilbert*, 104 B.R. 206 (Bankr. W.D. Mo. 1989), found that while a debtor did solicit votes prior to the approval of the Disclosure Statement, the creditor's votes should still count. In its decision, the court noted that the debtor did not act in bad faith or provide false information, there was a lengthy relationship between the debtor and creditor, and the creditor was sufficiently sophisticated and resourceful to protect its own interest.

If a Debtor is engaging in solicitation, what is the proper punishment for their behavior? Is the sophistication of the non-debtor parties to the Support Agreement relevant to the outcome?

Also, is it necessary for the Debtor's to obtain court approval prior to entry into a post-petition support agreement? If the Debtor obtains court approval, and inclusion of the non-debtor parties is subject to the approval by the Court of the Debtor's execution of the agreement, does this negate the risk of designation?

What Are the Limitations Imposed on Pre- and Post-Petition Support Agreements and How Should They Be Structured?

A. Creditor Requirements - Milestones: Creditors will often seek to impose expedited milestones to expedite the Debtor's emergence from bankruptcy. These milestones may include a timeline for entry of a final financing order, timing of the marketing and sales process in a 363 sale of assets, and timing of a plan of reorganization.

Many parties, including creditors' committees and potential purchasers of assets often challenge the timing as not permitting sufficient time to fully market and test the valuations set by the Debtors through a plan structure or stalking horse buyer. Lenders and other parties argue that they are not willing to provide additional resources through DIP financing to allow the Debtors the time limits requested by other parties.

How should Court's and other parties in interest evaluate the milestones? How do milestones interplay with the Debtor's fiduciary obligation to maximize value?

B. Debtor Requirements – Fiduciary Out. What type of limitations can be imposed on a Debtor in terms of its requirement to maximize returns for the benefit of the estate? Can the Debtor be bound to a certain Plan Term Sheet that reduces or eliminates their ability to pursue an alternative restructuring that may present itself after filing of the Support Agreement or the Disclosure Statement? Is there a difference between pre-petition support agreements and post-petition support agreements that have been negotiated for months following the petition?

C. Payment of Professional Fees of Non-Debtor Parties. Some support agreements require the Debtor to pay the professional fees and expenses of the non-debtor participants in

exchange for their support of the reorganization. Is entry into the Support Agreement a 'substantial contribution' that permits the allowance of the fees as an administrative expense of the estate?