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JUDICIAL REVIEW OF PLAN SUPPORT AGREEMENTS: A REVIEW AND ANALYSIS

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I. INTRODUCTION

Bankruptcies today are often made up of a swarm of corporate-subsidiaries with very deep and complicated capital structures.[1] Additionally, the secondary market in corporate debt is as vibrant as ever. This confluence of events has led to highly contentious confirmation hearings. As such, corporations entering into Chapter 11 have been executing pre-confirmation side agreements with their creditors in increasing numbers.[2] These agreements, or plan support agreements, are meant to lock up support for a proposed plan in advance of the plan confirmation hearing. Like any agreement, the weaker

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[1] *See*, *e.g.*, *In re* Innkeepers USA Trust, 442 B.R. 227, 236 (Bankr. S.D.N.Y. 2010) (discussing the new "fine art of being a debtor with multiple, separate tranches of debt secured by separate collateral pools").

[2] The first case that explicitly cited a plan support agreement was in 1993. *In re* Daisy Sys. Corp., No. C-92-1845-DLJ, 1993 WL 491309 (N.D. Cal. Feb. 3, 1993). Since then there have been 125 instances where a plan support agreement (or some iteration thereof) was cited by the court.

party, in this case the debtor-in-possession (hereinafter "debtor") must bargain away some of its rights to induce the stronger party, or the creditors to sign onto the agreement. Accordingly, if these bargains are left unchecked, debtors may give away valuable protections afforded to them by the Bankruptcy Code, in exchange for creditor entrance into the plan support agreement.

Plan support agreements, otherwise known as restructuring support agreements or lock-up agreements (hereinafter "PSA" "lock-up agreement" or "agreement"), are pre- or post-petition contracts entered into by the debtor and certain creditors, wherein the debtor and creditors agree to support a proposed reorganization plan subject to specific terms or conditions. PSA's are executed in order to "bind [the creditor and debtor] to a deal, even when the underlying restructuring documents remain to be drafted and executed[,]"[3] usually to complement prepackaged bankruptcy plans. Typically, the PSA prohibits both parties from soliciting or supporting any plan not memorialized within the agreement.[4] After executing the PSA and finalizing the terms therein, the plan proponent would file a disclosure statement with the court and solicit votes in accordance with the standard Chapter 11 plan confirmation process.[5]

This paper will concentrate on the two primary methods to object to the use of PSAs, various courts' responses to those objections, and the lack of judicial scrutiny that these objections provide. The first of these objections is a fact-intensive objection that the agreement proposed is not an exercise of the sound business judgment of the debtors and should therefore be disallowed under Section 365 for pre-

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[3] Official Comm. of Unsecured Creditors of New World Pasta Co. v. New World Pasta Co., 322 B.R. 560, 568 (M.D. Pa. 2005).

[4] PRACTICAL LAW PRACTICE, LOCK-UP AGREEMENTS IN BANKRUPTCY, n. 2-532-9406 (Maintained 2015).

[5] *Id.*

petition PSAs, and Section 363 for post-petition agreements. The second objection is that PSAs constitute impermissible solicitations of votes under Section 1125(b).[6]

The paper will begin by exploring the statutory protections afforded to debtors and creditors in the typical Chapter 11 plan confirmation process. The provisions of Chapter 11 are intended to force a dialogue between the debtor and its creditors with the goal of creating a plan of reorganization that is beneficial to all parties. The plan confirmation process sets out the framework for this negotiation. In addition, this section will discuss some of the overarching policies that are of concern in plan confirmations such as providing a fresh start to the honest but unfortunate debtor, and ensuring that a plan confirmation is not only fair but also appears fair.

The paper will proceed to provide an overview of why and how PSAs are used in bankruptcy proceedings. It will begin by examining the differing legal status of a PSA filed pre- and post- petition. It will then analyze the purpose of PSAs and the general terms that are found in these agreements. The terms include, *inter alia*, requiring support of a plan, trading restrictions, "no shop" provisions, and redress in case of a breach. The section will conclude by pointing out the various benefits PSAs confer on the bankruptcy estate.

The third section will track the evolving case law on both improper solicitation and the business judgment rule as it relates to plan support agreements. This section will analyze whether courts provide meaningful review of PSAs and posit that the answer is no. Aside from two unpublished memorandum orders in Delaware relating to an improperly solicited PSA and a 2010 Southern District of New York Bankruptcy opinion disallowing an egregiously unfair

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[6] *See infra* SECTION IV.

PSA, most PSA's have no formal review; nearly 89.6 percent of all PSAs are simply rubberstamped and approved.[7]

The paper will conclude by surveying the potential problems with the lack of scrutiny given to PSAs. These problems include (1) destroying value of the estate by hindering creditor negotiation and elongating the bankruptcy process; (2) circumventing the protections of Chapter 11 by using PSAs to form impermissible *sub rosa* plans; and (3) bypassing exclusivity by allowing a creditor, and not the debtor, to propose a plan of reorganization within the first 120 days of a bankruptcy petition.

II. PLAN CONFIRMATION IN CHAPTER 11

After exhausting all non-bankruptcy related options, the first step for a corporation nearing insolvency is to file for Chapter 11 protection.[8] The provisions of Chapter 11 aim to provide a fresh start for the honest but unfortunate debtor.[9] Concomitant with this goal is the idea that it is often preferable to allow a debtor to continue to operate or attempt to reorganize a failing business, rather than force the debtor to liquidate. Thus, Chapter 11 provides a route for corporations and partnerships to restructure their failing business. [10] Reinforcing the goals of Chapter 11 is the court's review of a debtor's reorganization plan. Subchapter II of Chapter 11 outlines the formation

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[7] S*ee also infra* SECTION IV.

[8] W. HOMER DRAKE JR. & CHRISTOPHER S. STRICKLAND, CHAPTER 11 REORGANIZATIONS § 1:1 (2d ed. 2014).

[9] *See*, *e.g.,* Marrama v. Citizens Bank, 549 U.S. 365, 367 (2007) ("Congress gave honest but unfortunate debtor[s], the chance to repay their debts should they acquire the means to do so[.]") (internal quotations and citations omitted).

[10] *See* Craig A. Sloane, *The Sub Rosa plan of Reorganization: Side-Stepping Creditor Protections in Chapter 11*, 16 BANKR. DEV. J. 37, 40 (1999) ("Chapter 11 contains the primary reorganization provisions of the Bankruptcy Code and the only reorganization provisions available for corporate or partnership debtors.").

and confirmation of a debtor's plan of reorganization. The plan confirmation process is devised to force all parties with an interest in the reorganized estate to the negotiating table.[11] Accordingly, Subchapter II carefully balances the protections offered to both the debtor and its various creditors.[12]

At the outset of a restructuring, the debtor is given a 120-day exclusive period to propose a restructuring plan. If the debtor files a plan within this exclusivity period, the debtor receives an additional 180 days to solicit (i.e. present the plan to the parties necessary to confirm the plan) votes for its proposed plan.[13] The debtor's plan, subject to certain requirements and restrictions, may modify the rights of any class of creditors or equity holders and is confirmable even in the face of opposition from some classes. [14] During the exclusivity period creditors also receive certain protections. Chief among them is the right to obtain dismissal of a case that was filed in bad faith or for which there is no viable plan.[15] In addition, once the debtor's exclusivity period has run, a creditor may file its own restructuring plan with the court.[16]

Aside from prepackaged bankruptcies, a proponent of a restructuring plan must file a disclosure statement with the court before soliciting votes for the plan.[17] Section 1125(b) provides that "[a]n acceptance or rejection of a plan may not be solicited . . . unless, at the time of or before such solicitation, there is transmitted to such holder

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[11] DRAKE & STRICKLAND, *supra* note 8, § 1:1.

[12] *Id.*

[13] 11 U.S.C. § 1121(b) (2014).

[14] *See* ALAN N. RESNICK & HARRY J. SOMMER, 7 COLLIER ON BANKRUPTCY ¶¶ 11006–1100.01
(16th rev. ed. 2015) (citing 11 U.S.C. § 1121(c) (2014)).

[15] *Id.*

[16] *Id.*

[17] 11 U.S.C. § 1125(b) (2014).

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*."[18] Adequate information is defined as "information of a kind, and in sufficient detail . . . that would enable a *hypothetical reasonable investor* typical of the holders of claims or interests of the relevant class to make an informed judgment about the plan[.]"[19] A disclosure statement provides protections to the unsophisticated creditor without access to detailed information about the debtor's affairs.[20] Failure to file a disclosure statement could result in a disqualification or "designation" of all votes improperly solicited.[21]

In a prepackaged bankruptcy, or "prepack", the acceptance of the plan is sought before the debtor ever files for Chapter 11. The goal of a prepack is to make a Chapter 11 case "as quick and painless as possible for [the] creditors."[22] In prepacks, a plan proponent is permitted to solicit votes for the acceptance of a plan before filing a disclosure statement—provided the proponent adheres to all applicable non-bankruptcy laws.[23] Once the proponent receives the requisite acceptances, it may file for bankruptcy protection and petition the court to immediately proceed to a confirmation hearing.[24] If the proponent

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[18] *Id.* (emphasis added).

[19] 11 U.S.C. § 1125(a) (2014).

[20] *See, e.g., id.* (describing the necessary disclosure attendant to a proposed Plan).

[21] *See, e.g., In re* Indianapolis Downs, LLC., 486 B.R. 286, 293 (Bankr. D. Del. 2013) (denying motion to designate votes locked up before a disclosure statement was filed as part of debtors restructuring support agreement).

[22] *In re*: Genco Shipping & Trading Ltd., 509 B.R. 455, 461-62 (Bankr. S.D.N.Y. 2014) (internal quotations omitted).

[23] *See* 11 U.S.C. § 1126(b)(1) (2014) ("holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan, as the case may be, if—(1) the solicitation of such acceptance or rejection was in compliance with any applicable nonbankruptcy law . . . ").

[24] RESNICK, *supra* note 14, at 1100.10.

is unable to solicit the requisite acceptances before filing, it may instead file for bankruptcy while simultaneously filing its disclosure statement with the court. In these circumstances, known colloquially as "prenegotiated" bankruptcies, the proponent is able to solicit votes for its plan under the solicitation requirements and protections of the Bankruptcy Code, which may be more flexible than the applicable non-bankruptcy requirements.[25]

After filing a disclosure statement and soliciting votes for a plan (or soliciting those votes prepetition) the plan must be confirmed by a court in accordance with Section 1129 of the Bankruptcy Code. To ensure the fairness of the plan, Section 1129(a) provides a list of 16 different requirements that a plan must satisfy before it could be confirmed.[26] In addition, the plan confirmed must not only be fair but must seem fair.[27] In that way the plan confirmation process balances the competing interests of the creditors looking to maximize value, and the debtor whose hope is to stay alive. While the typical plan confirmation process ensures that this balance is struck, the increased use of plan support agreements—specifically their ability to circumvent the protections of 1129—has the potential to derail this delicate balance.[28]

III. PLAN SUPPORT AGREEMENTS DEFINED

A plan support agreement is a contract between a debtor and its significant creditors memorializing the terms of a negotiated plan of

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[25] *Id.*

[26] 11 U.S.C. § 1129(a) (2014); *see also* Sloane, *supra* note 10, at 45 ("The plan process is essentially one of fairness that invites the participation, through negotiation and voting, of all creditors and interest holders.").

[27] *In re* Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) ("The conduct of bankruptcy proceedings not only should be right but must seem right").

[28] *See Infra* SECTION IV (describing the problems associated with certain plan support agreements).

reorganization. Typically, PSAs provide that a significant creditor, or a group of creditors, support a restructuring plan subject to certain terms and conditions. These terms include, *inter alia*, "drafting and court approval of a disclosure statement, the drafting of an actual plan that is satisfactory to the locked-up parties, and that the debtor suffer no material adverse changes during the pendency of the chapter 11 case."[29] Customarily, PSAs are entered into prepetition in connection with a prepack or prenegotiated bankruptcy petition, however, they can be entered into postpetition as well. The object of a PSA is to lock up the votes of enough creditors before filing a restructuring plan, in order to ensure that the solicitation and confirmation process will be as quick and predictable as possible.[30]

While no two PSAs are alike, there are certain standard terms common to all of them. Chief among these conditions is that signatories agree to support the properly solicited memorialized plan. Depending on the agreement, this support ranges from agreeing not to take any action to delay confirmation of a plan, to requiring a positive vote in favor of a restructuring plan.[31] In addition, many lockup agreements include trading restrictions. These restrictions prohibit the assigning of a claim that was originally subject to the PSA unless the assignee agrees to sign onto the PSA and be bound by its terms.[32] Without these restrictions the majority of plan support agreements would be rendered useless by the time the restructuring plan is filed

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[29] Daniel J. DeFranceschi, *Delaware Bankruptcy Court Announces Bright-Line Rule for Use of Lock-Up Agreements in Chapter 11 Cases*, 22 AM. BANKR. INST. J. 16, 16 (2003).

[30] *See* ZIRINSKY, ET AL., RECENT ISSUES IN PLAN CONFIRMATION, 051613 ABI-CLE 307 (2013) ("The parties to the agreement commit to voting for a plan that reflects the terms and conditions in the agreement, thus providing some certainty that a conforming plan will be approved when put to a vote of creditors.")

[31] PRACTICAL LAW PRACTICE, *supra* note 4.

[32] *Id.*

with the court.[33] Other terms common to plan support agreements are specific performance as a remedy for breach, termination provisions, and fiduciary outs for the debtors.[34]

Plan support agreements serve an outsized, and often beneficial,[35] role in large complex restructurings.[36] In those restructurings, PSAs are utilized to convince prospective lenders and investors that the debtor is pursuing a viable restructuring plan.[37] At the same time, PSAs help reduce the cost and length of bankruptcy proceedings, reduce the negative publicity associated with elongated stays in bankruptcy, and assure the market that the debtor will exit the bankruptcy proceedings without causing too much disruption to employees, customers or partners of the debtor.[38] In addition to the benefits that PSAs confer upon the debtor, creditors often receive concessions from the debtor to encourage their entrance into the PSA. These concessions include favorable payment terms, interest rates, payment schedules, debt-to-equity conversions, and liability releases. [39] By encouraging creditors and debtors to solve their problems through negotiation rather than the courts, the use of PSAs has the additional

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[33] *See, e.g., id.* ("Given the large volume of trading in the distressed claims trading market, debtors are concerned that any agreement reached with a class of creditors could be nullified by future buyers of the claims in that class.").

[34] *Id.*

[35] *See id.* (describing the benefits of plan support agreements).

[36] *See* Mayr, A. Kurt, *Unlocking the Lockup: The Revival of plan support Agreements Under New § 1125(g) of the Bankruptcy Code*, 15 J. BANKR. L. & PRAC. 729, 730 (2006) ("Plan support/lockup agreements are an essential tool in out-of-court workouts and so-called "prenegotiated" or "prearranged" Chapter 11 cases.")

[37] PRACTICAL LAW PRACTICE, *supra* note 4.

[38] Orrick, Herrington & Sutcliffe LLP, *The What, Who, Why and When of Plan Support Agreements, available a*t https://www.orrick.com/Events-and-Publications/Documents/2905.pdf.

[39] PRACTICAL LAW PRACTICE, *supra* note 4.

benefit of hastening the bankruptcy process, thereby maximizing value for the estate.[40]

There are two primary methods to obtain judicial approvals of plan support agreements. For PSAs that were entered into prepetition, a debtor would typically file a motion with the court seeking to assume the agreement as an executory contract under Section 365 of the Bankruptcy Code.[41] Under Section 365, a debtor may, subject to the courts approval, "assume or reject any executory contract or unexpired lease."[42] A court reviewing the PSA would approve the assumption of the agreement "upon a showing that the debtor's decision to take such action will benefit the debtor's estate and is an exercise of sound business judgment."[43] Generally a court will not second-guess the debtor's business judgment when analyzing whether the assumption will benefit the estate. However, where there is indication of insider action, the court may employ heightened scrutiny.[44] As described by Collier:

> "In reviewing these … decisions, courts have employed what has been described as 'a sliding scale' of scrutiny, with the most searching standard of review being accorded to transactions not in the ordinary course of business, transactions in which there is a potential for managerial self-dealing

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[40] *See e.g., In re* Genco Shipping & Trading Ltd., 509 B.R. 455, 462 (Bankr. S.D.N.Y. 2014) ("[w]hen a Chapter 11 case is not concluded quickly, debtors and their stakeholders can be grievously injured by the destruction of value").

[41] *See, e.g., id.* at 455 (decided a motion to assume a restructuring support agreement).

[42] *Id*. at 462.

[43] *Id*.

[44] *See In re* Innkeepers USA Trust, 442 B.R. 227, 231 (Bankr. S.D.N.Y. 2010) (discussing the requirements for heightened scrutiny).

> and transactions that by virtue of their sheer size or substance could dictate the outcome of the case or the terms of a reorganization plan."[45]

Relatedly, a plan support agreement entered into postpetition is subject to court review under Section 363 of the Bankruptcy Code.[46] Section 363 provides that a debtor must seek court approval for any transactions that occur "outside the ordinary course of business" and use up property of the estate.[47] Because the entrance into a PSA is outside the ordinary course of business and inevitably uses up property of the estate, a court would only approve entrance thereto if the debtor can demonstrate a sound business judgment for the transaction.[48] Similar to the standard for assumption under Section 365, once "the debtor articulates a reasonable basis for its business decisions . . . courts will generally not entertain objections to the debtor's conduct."[49] Likewise, where there is evidence of an insider transaction, a heightened scrutiny applies. When applying heightened scrutiny, courts review the action for its "entire fairness… typically examining whether the process and price of a proposed transaction not only appear fair but are fair and whether fiduciary duties were properly taken into consideration."[50]

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[45] RESNICK, *supra* note 14, at 1108.07.

[46] *See, e.g., In re* Residential Capital, LLC, No. 12-12020, 2013 WL 3286198, at *1 (Bankr. S.D.N.Y. June 27, 2013) (reviewing a motion to approve a postpetition PSA under Section 363).

[47] 11 U.S.C. § 363(b)(1) (2014).

[48] *See Residential Capital*, 2013 WL 3286198 at *18 (describing the standard of review for approval of a PSA pursuant to Section 363).

[49] *Id.* (internal quotation marks omitted).

[50] *Id*.

IV. COURT REVIEW OF PLAN SUPPORT AGREEMENTS

There are three ways in which a court could review a plan support agreement. The first occurs upon entrance into the PSA—or assumption if the PSA was entered into prepetition. In these situations a court reviews the plan support agreement under the business judgment standard.[51] The second and third occur at the plan confirmation hearing. During the confirmation hearing, a plan support agreement could be challenged for impermissibly locking up votes of the signatories[52] or for violating various provisions of the Bankruptcy Code.[53] If the challenge was successful, the votes locked up would be designated in accordance with Section 1126(e), or the proposed plan would be rejected.[54] The section that follows will discuss court review of plan support agreements and demonstrate how the available methods for review do not provide adequate protection for creditors who are not parties to the agreements.

The majority of plan support agreements are negotiated and executed prepetition without any input from the Bankruptcy Court. [55] To be enforceable postpetition, these agreements, along with those negotiated postpetition, must be approved by the Bankruptcy Court under Section 363 or 365. There are only 125 documented instances in which plan support, restructuring support or lockup agreements

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[51] *Infra* SECTION III.

[52] *See In re* NII Holdings, Inc., No. 02-11505, Order, dated (Bankr. D. Del. Oct. 25, 2002) ECF No. 367 (designating signatories to PSA's votes) (referenced *in* RESNICK, *supra* note 14, at 1125.05).

[53] *See In re* Bush Indus., 315 B.R. 292, 304 (Bankr. W.D.N.Y. 2004) (rejecting the PSA and denying confirmation for lack of good faith).

[54] *See infra* notes 57 and 58.

[55] *See* DeFranceschi, *supra* note 29, at 16 ("Usually, lock-up agreements are agreed to and fully executed prior to filing the chapter 11 case, together will the terms of the proposed restructuring.").

are mentioned by a court in any context.[56] In 112 of the 125, the PSA mentioned was approved, either explicitly or implicitly, without any meaningful discussion or review. In the remaining 13 cases, various courts ruled in favor of the PSA proponents ten times.[57] Since 1988, there have only been five documented instances of a court rejecting a plan support agreement or a portion thereof.[58] Two of the five instances are unpublished memorandum decisions that only exist as part of a reference in various cases and in Collier on Bankruptcy.[59]

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[56] The search, narrowed down by practice area bankruptcy, all fed: adv: ("Plan Support Agreements" or "Plan Support Agreement" or PSA or RSA or "Restructuring support agreement" or "Restructuring support agreements" or "Lock-up agreement" or "Lockup agreement" or "Lock-up agreements" or "Lockup agreements") results in 945 cases, of which 820 cite to the terms in another context.

[57] Official Comm. of Unsecured Creditors of New World Pasta Co. v. New World Pasta Co., 322 B.R. 560 (M.D. Pa. 2005); *In re* Kellogg Square P'ship, 160 B.R. 336 (Bankr. D. Minn. 1993); *In re* Texaco Inc., 81 B.R. 813 (Bankr. S.D.N.Y. 1988); *In re* Bush Indus., 315 B.R. 292 (Bankr. W.D.N.Y. 2004); *In re* Heritage Org., 376 B.R. 783 (Bankr. N.D. Tex. 2007); *In re* Marketxt Holdings Corp., 361 B.R. 369 (Bankr. S.D.N.Y. 2007); *In re* Innkeepers USA Trust, 442 B.R. 227 (Bankr. S.D.N.Y. 2010); *In re* TCI 2 Holdings, LLC, 428 B.R. 117 (Bankr. D.N.J. 2010); *In re* Residential Capital, LLC, 497 B.R. 720 (Bankr. S.D.N.Y. 2013); *In re* Residential Capital, LLC, No. 12-12020, 2013 WL 3286198 (Bankr. S.D.N.Y. June 27, 2013); *In re* Genco Shipping & Trading Ltd., 509 B.R. 455 (Bankr. S.D.N.Y. 2014).

[58] *In re* Bush Indus., 315 B.R. 292 (Bankr. W.D.N.Y. 2004); *In re* Innkeepers USA Trust, 442 B.R. 227 (Bankr. S.D.N.Y. 2010); *In re* TCI 2 Holdings, LLC, 428 B.R. 117 (Bankr. D.N.J. 2010); Order, *In re* NII Holdings, Inc., No. 02-11505 (Oct. 25, 2002) ECF No. 367(designating signatories to PSA's votes) *referenced in* RESNICK, *supra* note 14, at 1125.05; *In re* Stations Holdings, , Order, No. 02-11505 (Bankr. D. Del. Oct. 25, 2002) ECF No. 367), *referenced in* RESNICK, *supra* note 14, at 1125.05.

[59] *See Residential Capital*, 2013 WL 3286198, at *20 n.5 (noting that "[t]hese orders are neither available on Westlaw, Lexis, or PACER. The description [of the cases] relies on the summary of the orders contained in Collier."); RESNICK, *supra* note 14, at 1125.05 (describing the two decisions).

Two dealt with agreements that were in violation of the plan confirmation process.[60] The final case was riddled with evidence of bad faith.[61]

A. BUSINESS JUDGMENT STANDARD

The first method by which a court may review a plan support agreement is during the assumption, or approval, stage of the agreement. The standard for review for both prepetition assumption and postpetition approval of a PSA is the business judgment rule.[62] The business judgment rule, first articulated in the landmark Delaware case *Smith v. Van Gorkem*,[63] is a doctrine that focuses on procedural fairness.[64] Contrarily, the Bankruptcy Code, in particular the plan confirmation process, favors substantive fairness over procedural.[65] Due to this dichotomous relationship, the use of the business judgment rule to approve elements of the bankruptcy process is inapposite. [66]

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[60] *In re* TCI 2 Holdings, LLC, 428 B.R. 117 (Bankr. D.N.J. 2010); *In re* Bush Indus., 315 B.R. 292 (Bankr. W.D.N.Y. 2004); *see also Infra* SECTION IV(c).

[61] *See Innkeepers*, 442 B.R at 232 (holding that the PSA was entered into in bad faith.)

[62] *Infra* SECTION III; *see also Residential Capital*, 2013 WL 3286198, at *18-19 (analyzing a 363 approval of a PSA by reference to a 365 assumption); *Genco Shipping*, 509 B.R. at 464 ("The standard used for judicial approval of the use of estate property outside of the ordinary course of business is also the business judgment of the debtor.").

[63] 488 A.2d 858 (Del. 1985).

[64] *See generally* Lynn A. Stout, *In Praise of Procedure: An Economic and Behavioral Defense of Smith v. Van Gorkom and the Business Judgment Rule*, 96 NW. U. L. REV. 675 (2002).

[65] *See, e.g.*, *In re* Ira Haupt & Co., 361 F.2d 164, 168 (2d Cir. 1966) ("The conduct of bankruptcy proceedings not only should be right but must seem right.").

[66] Realizing this, the most recent ABI commission report recommended adding a substantive fairness requirement to 363 sales of substantially all a debtors assets. *See* D.J. BAKER ET. AL., AMERICAN BANKRUPTCY INSTITUTE COMMISSION TO STUDY THE REFORM OF CHAPTER 11, 201-203 (2014), *available at* http://business-finance-restructuring.weil.com/wp-content/uploads/2014/12/Ch11CommissionReport.pdf.

In re Innkeepers USA Trust[67] is the singular case in which a PSA was rejected at the assumption or approval stage of the agreement. In *Innkeepers*, the debtor, a hotel chain, motioned to have its prepetition plan support agreement assumed by the court. The terms of the PSA had provided that Lehman, the debtor's largest creditor, received *inter alia* all issued and outstanding common stock issued by the reorganized debtor in satisfaction of Lehman's secured claims. All other secured creditors would receive new secured notes "with a value that is not less than the value of the collateral securing their prepetition debt."[68]

At the outset of the hearing, the parties disagreed as to which standard the court should employ to review the PSA. The debtors argued that as with any assumption motion, the court should employ the relatively lax business judgment standard. The creditors, however, maintained that since a parent of the debtor was both involved in the negotiations and received a benefit as a result of the PSA, the court should employ the heightened entire fairness standard of review.[69] Avoiding this question, the court rejected the PSA, holding that the debtors failed to meet their burden for assumption under both the business judgment and entire fairness standard of review. In so holding, the court noted that the debtors acted egregiously in their negotiations and failed to meet the five elements necessary for business judgment protection.[70]

First, Apollo's—the debtors' parent company—involvement in the transaction precluded a finding of disinterestedness.[71] Second,

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[67] 442 B.R. 227 (Bankr. S.D.N.Y. 2010).

[68] *Id.* at 230.

[69] *Id.* at 231.

[70] *Id.* The elements are: (i) a business decision, (ii) disinterestedness, (iii) due care, (iv) good faith, and (v) according to some courts and commentators, no abuse of discretion or waste of corporate assets.

[71] *Id.*

the court found that the debtors failed to both "shop" the deal around the market and to disclose to the creditors the terms of the potential deal with Lehman before signing the agreement, hence it did not exercise due care.[72] Third, the court found that the debtors failed to act in good faith when making the decision to enter into the PSA. The court focused on the lack of transparency during the negotiation process, evinced by the debtors forbidding other creditors from accessing the same data that Lehman accessed. Furthermore, the court paid particular attention to the benefits that Apollo received from the transaction, noting that "[t]he intention for Apollo to end up with half of the Debtors' equity . . . has been, at best, downplayed and, at worst, obfuscated from parties in interest."[73] Fourth, the court found that the purported benefits to execution of the PSA were immaterial, in that it only locked up the votes of one creditor and about $200 million of the more than $1.3 billion in secured debt.[74] Last, and of "paramount importance," the debtors' fiduciary out was flawed.[75]

The *Innkeepers* decision represents an important step towards meaningful review of plan support agreements. The decision is the first to outline the factors a court should apply when reviewing a plan support agreement.[76] Chief among them is that the debtors' lack of transparency could result in a PSA being rejected at the assumption or approval stage.[77] However, the *Innkeepers* decision was soon distinguished in two subsequent decisions out of the same court—

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[72] *Id.*

[73] *Id.* at 234.

[74] *Id.* at 235.

[75] *Id.*

[76] *See* Joao F. Magalhaes, *Not Enough Hospitality to All Creditors? PSA Denied Between Innkeepers USA Trust and Lehman Ali Inc.*, 30 AM. BANKR. INST. J. 28 (2011) (Although Innkeepers was a bench decision that did not feature dissertations on governing Code provisions or case law, it raises factors for courts to apply when reviewing any PSA).

[77] *Id.*

enshrining the lax business judgment rule as the preeminent standard for assuming or approving PSAs and all but foreclosing meaningful review at this stage of the litigation.[78]

B. DESIGNATION OF VOTES

The second method by which a court could review a plan support agreement is in response to a motion to designate the votes of the signatories under Section 1126(e) of the Bankruptcy Code. Section 1126(e) 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 solicited . . . in accordance with the provisions of this title."[79] There are three scenarios—each is governed by a different provision of the Bankruptcy Code—in which a plan support agreement may be entered into by a debtor: (1) prepetition in connection with a prepack plan, (2) postpetition in connection with a prenegotiated plan, and (3) postpetition generally. The date in which negotiations over the PSA begin is critical in a designation review.

1. Plan Support Agreements Negotiated Prepetition

As previously mentioned, the majority of plan support agreements are negotiated and executed prepetition. These agreements are

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[78] In *In re Genco Shipping & Trading Ltd*, the court allowed the assumption of a restructuring support agreement, and approved the RSA's termination fee because of the "monetary benefit to the estate." 509 B.R. 455, 467 (Bankr. S.D.N.Y. 2014) (noting that this case is distinct from *Innkeepers* because the transaction as at arms length throughout). In *In re* Residential Capital, LLC, the court declined to apply the entire fairness standard to a transaction in which one company sat as both a creditor and the major beneficiary of the PSA, and was thus on both sides of the transaction. No. 12-12020, 2013 WL 3286198, at *10 (Bankr. S.D.N.Y. June 27 2013) (distinguishing *Innkeepers* because the negotiations were led by an independent examiner).

[79] 11 U.S.C. § 1126(e) (2014).

governed by Section 1126(b) of the Bankruptcy Code. Section 1126(b) provides that a claimholder who has rejected or accepted a plan of reorganization before commencement of the bankruptcy case, is deemed to have accepted or rejected said plan subject to two conditions.[80] First, the solicitation of the votes must have been done in compliance with all applicable non-bankruptcy laws. Second, if there are no applicable non-bankruptcy laws, solicitation cannot occur until the proponent has provided the claimholders with adequate information as defined in Section 1125(a).[81]

In many circumstances, although negotiations for a plan support agreement begin prepetition, the parties are unable to execute the agreement before commencement of the case. In these circumstances, any motion to designate the votes of locked up parties will be governed by Section 1125(g) of the Bankruptcy Code—enacted in 2005. Section 1125(g) provides that "an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law *and if such holder was solicited before the commencement* of the case in a manner complying with applicable nonbankruptcy law."[82] Utilizing Section 1125(g), a debtor who had successfully negotiated a reorganization plan, but for some reason had not received a PSA signed by all parties prepetition, may continue its negotiations without first filing a disclosure statement. Thus, as long as the plan proponent complies with all applicable non-bankruptcy laws, 1126(e) does not provide the courts

[80] 11 U.S.C. § 1126(b) (2014).
[81] *Id.*; *see also* Daniel J. DeFranceschi, *supra* note 29, at 16.
[82] 11 U.S.C. § 1125(g) (2014) (emphasis added).

with an avenue to review PSAs negotiated and or executed prepetition.[83]

2. Plan Support Agreements Negotiated Postpetition

The remainder of PSAs are those negotiated and executed postpetition. Section 1125(b) of the Bankruptcy Code governs these agreements. Section 1125(b) prohibits a plan proponent from soliciting votes in support of a proposed plan after the commencement of a case, unless the proponent first files a written disclosure statement with the court.[84] A court's decision on whether to designate votes locked up by a PSA depends on its interpretation of the solicitation requirement of 1125(b). Notably, solicitation is left undefined in the Bankruptcy Code.[85] Courts have generally split on their definition of solicitation. The majority defines solicitation narrowly, holding that solicitation only occurs when there is an "official vote for or against a plan."[86] A minority of courts define solicitation broadly, holding that solicitation can occur during certain postpetition negotiations.[87] A court's view on solicitation is paramount in the enforceability of PSAs. Parties negotiating plan support agreements in jurisdictions who define solicitation narrowly have room to negotiate without fear of violating the solicitation requirements of 1125 and thus, having their votes designated in a confirmation hearing.[88]

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[83] *See e.g.* Daniel J. DeFranceschi, *supra* note 29, at 16 (noting that the *NII Holdings* court considered a lock-up agreement fully executed pre-petition, and held that the court did not have jurisdiction to designate the votes of the locked up parties).

[84] 11 U.S.C. § 1125(b) (2014).

[85] RESNICK, *supra* note 14, at 1125.05.

[86] PRACTICAL LAW PRACTICE, *supra* note 4.

[87] *Id.*

[88] *Id.*

Majority View: Narrow Interpretation. Judge Clark first articulated the majority view on solicitation in the decision *In re Snyder*.[89] In *Snyder*, a Utah Bankruptcy Court held that the term solicitation in Section 1125(b) should relate to the formal process of voting only — i.e. where the ballot and disclosure statements are presented to the creditors in relation to a specific plan. [90] The court held that solicitation should not be read so broadly "as to chill the debtor's postpetition negotiation with its creditors."[91]

Three years later, the Third Circuit was asked to decide whether to designate the votes of certain creditors who, at the confirmation hearing, had rejected the debtor's proposed plan after having earlier received a copy of a competing plan filed without a disclosure statement. Previously, the bankruptcy court had ruled for the debtor, invalidating the votes of those creditors. The district court reversed and the debtor appealed.[92] In the seminal case *Century Glove Inv. v. First American Bank*, the Third Circuit affirmed the district court's decision and specified that:

> "[S]olicitation must be read narrowly. A broad reading of § 1125 can seriously inhibit free creditor negotiations … . The purpose of negotiations between creditors is to reach a compromise over the terms of a tentative plan. The purpose of compromise is to win acceptance for the plan. We find no principled, predictable difference between negotiation and solicitation of future acceptances. We therefore reject any

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[89] 51 B.R. 432 (Bankr. D. Utah 1985).
[90] RESNICK, *supra* note 14, at 1125.05 (*In re* Snyder, 51 B.R. 432 (Bankr. D. Utah 1985).
[91] *Id.*
[92] Century Glove Inv. v. First Am. Bank, 860 F.2d 94, 95-96 (3d Cir. 1988).

> definition of solicitation which might cause creditors to limit their negotiations."[93]

In essence, the *Century Glove* court found that the way to produce the best possible plan in a restructuring is to encourage postpetition negotiation, even in the absence of a disclosure statement.[94] As described by the Delaware Bankruptcy Court in *In re Indianapolis Downs*,[95] *Century Glove* stood for the proposition that courts must be "chary of construing those disclosure and solicitation provisions in a way that chills or hamstrings the negotiation process that is at the heart of Chapter 11."[96]

In five instances various courts have construed 1125(b)'s solicitation requirements narrowly and refused to designate votes locked up in PSAs executed postpetition. In the first of these, *In re Kellogg Square P'ship*,[97] the debtor renegotiated a contract for heating with one of its creditors—District Energy—and as part of the renegotiations, District Energy agreed to vote in favor of the debtor's plan.[98] During the confirmation hearing, Prudential, a creditor of the debtor, moved to designate the votes locked up by the agreement. The court denied Prudential's motion, holding, like the court in *Snyder*, that bankruptcy law should favor settlements.[99] The court continued, finding that in order to designate District Energy's votes "the act by which the Debtor 'solicited' District Energy's vote must be . . . only when the Debtor's plan and disclosure statement and a ballot were actually

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[93] *Century Glove,* 860 F.2d at 101–02.
[94] *Id*.
[95] 486 B.R. 286 (Bankr. D. Del. 2013).
[96] *Id.* at 297.
[97] 160 B.R. 336 (Bankr. D. Minn. 1993).
[98] *Id.* at 340.
[99] *Id.*

presented to District Energy in the formal process specified by [Section] 1125(b)."[100] Similarly, courts in Texas,[101] Pennsylvania,[102] Delaware,[103] and New York,[104] have interpreted the solicitation requirement of 1125(b) narrowly and declined to designate votes locked up by the plan support agreement accompanying each case.

Minority View: Broad Interpretation. Other courts have interpreted solicitation more broadly. These courts are more willing to designate votes locked up in a PSA that was fully negotiated postpetition. The minority viewpoint is primarily focused on "protection of the debtor's exclusive right to propose a plan within the exclusivity period."[105] For example, the court in *In re Temple Retirement Community Inc.*,[106] held that the indentured trustee was not required to forward to the creditors a dissenting bondholder's competing plan before the bondholder filed a disclosure statement with the court.[107]

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[100] *Id.*

[101] *In re* Heritage Organization, 376 B.R. 783 (Bkrtcy. N. D. Tex. 2007) (citing *Kellogg Square*, 160 B.R. at 339–40) (denying the motion to designate locked-up votes on three grounds, including on the grounds that solicitation only applies to formal act of requesting a vote after filing a disclosure statement, and not postpetition negotiations).

[102] Official Comm. of Unsecured Creditors of New World Pasta Co. v. New World Pasta Co., 322 B.R. 560, 568 (M.D. Pa. 2005) (denying the motion to designate locked-up votes because agreement signed contains termination rights if a requisite amount of prepetition lenders find the plan proposed to be unacceptable).

[103] *In re* Indianapolis Downs, LLC., 486 B.R. 286, 295 (Bankr. D. Del. 2013) ("Designation of votes in this case would be demonstrably inconsistent with the purposes of the Bankruptcy Code").

[104] *In re* Residential Capital, LLC, No. 12-12020, 2013 WL 3286198, at *20 (Bankr. S.D.N.Y. June 27, 2013) (denying motion to designate locked up votes because of the "numerous termination events that allow a party to withdraw from [the] obligation [to vote]").

[105] Robert J. Keach, *A Hole in the Glove: Why "Negotiation" Should Trump "Solicitation"*, 22 AM. BANKR. INST. J. 22, 43 (2003).

[106] 80 B.R. 367 (Bankr. W.D. Tex. 1987).

[107] *Id.* at 370.

The court reasoned that because the debtor was still within its exclusivity period, the bondholder could not file a disclosure statement and thus any competing plan would be improperly solicited.[108] Likewise, the court in *In re Gilbert*[109] held that merely expressing ones hope that a creditor would vote a certain way could be an impermissible solicitation of that creditor's vote.[110]

Some courts have also chosen to interpret the solicitation requirements broadly where there is evidence that the solicitation was not part of a negotiation with creditors.[111] In *In re Aspen Limousine Service,*[112] the court held that a letter sent by a plan-proponent to all creditors before the court approved a disclosure statement, was an impermissible solicitation. Distinguishing *Century Glove*, the court noted that because the letter was sent to all creditors, and not just a select few, the sender could not plausibly argue that the letter was meant to be a negotiation. Rather, the letter was "a deliberate and unabashed attempt to circumvent the confirmation and solicitation procedures established by the bankruptcy court."[113]

In 2002, the Bankruptcy Court for the District of Delaware, specifically Judge Walrath, adopted a broad interpretation of solicitation when it designated the votes of creditors that were cast pursuant to two different postpetition PSAs.[114] The first of these rulings, *In re Stations Holding Co., Inc.*,[115] dealt with a PSA executed in order to facilitate the sale of the debtor's assets to a third party. While reviewing

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[108] PRACTICAL LAW PRACTICE, *supra* note 4 (citing *Temple*, 80 B.R. at 369).
[109] 104 B.R. 206 (Bankr. W.D. Mo. 1989).
[110] Keach, *supra* note 105 (citing *Gilbert*, 104 B.R. at 214-215).
[111] *Id.*
[112] 193 B.R. 325 (D. Colo. 1996).
[113] Keach, *supra* note 105.
[114] RESNICK, *supra* note 14, at 1125.05.
[115] Order Granting Motion of the United States Trustee Pursuant to Sections 1125(b) and 1126(d) and (e) of the Bankruptcy Code to Designate All Persons Who Executed Post-Petition Lockup Agreements and to Direct that Their Ballots Not be Counted,

the transaction, the court found that "solicitation", as used in Section 1125(b), means asking for a vote.[116] Thus, a plan support agreement that locks up a creditor's vote and is executed postpetition inevitably "solicits" votes from the signatories, and can only be executed after the filing of a disclosure statement. Because no disclosure statement was filed, the locked up votes were not counted in favor of the confirmation.[117]

In the second case, *In re NII Holdings, Inc.*,[118] the PSA negotiations took place prepetition. Because the debtor filed on the Friday before Memorial Day, the execution of the PSA did not occur until a few days after the petition date. The signatories to the PSA included the public noteholders who held 99% of the unsecured claims, and the agreement was universally applauded for it provided $100 million dollars-worth of exit financing. Nevertheless, the U.S. Trustee sought to designate the votes of the creditors for being improperly solicited. Despite the fact that the plan had been "overwhelmingly approved", and no one with an economic stake in the restructuring had objected to the PSA or solicitation process, the Bankruptcy Court designated the noteholders votes.[119] In doing so, the court held that Section 1125(b) creates a "bright-line rule" prohibiting any PSA that was signed postpetition.[120] Although often distinguished[121], the decisions

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and/or for Sanctions or Other Relief, *In re* Stations Holding Company, Inc., No. 02-10882 (Bankr. D. Del. Sept. 30, 2002) ECF No. 177.

[116] Daniel J. DeFrancesc, *supra* note 29, at 55.

[117] *Id.*

[118] Order, No. 02-11505 (Bankr. D. Del. Oct. 25, 2002) ECF No. 367.

[119] Mayr A. Kurt, *supra* note 36. Note, the outcome of this case would have differed had it been brought after the adoption of 1125(g), which specifically carves out an exception for agreements negotiated prepetition but executed postpetition. 11 U.S.C. § 1125(g) (2014).

[120] *Id.*

[121] *See* RESNICK, *supra* note 14, at 1125.05 ("Later opinions and commentary have distinguished these cases on the grounds that the agreements at issue included specific

in *Station* and *NII Holdings* casted a serious doubt on the validity of PSAs executed without filing a disclosure statement.[122]

In Re Indianapolis Downs. In 2013, the Delaware Bankruptcy Court revisited the question of whether plan support agreements are per se illegal, in its decision *In re Indianapolis Downs*.[123] The debtors in *Indianapolis Downs*—operators of a horse racing track and a casino—filed a voluntary Chapter 11 petition with the court. At the time of filing, the debtors owed over $551 million, secured by substantially all of their assets.[124] After months of postpetition negotiation, the debtors, and two of their creditors, agreed on a restructuring plan that included a sale of assets or, in the alternative, a recapitalization. This agreement was memorialized in a Restructuring Support Agreement ("RSA"), and signed in April of 2012, a little over one year after the petition date. [125]

The RSA provided for, *inter alia*, (1) specific terms of the agreed upon reorganization plan, (2) that the debtors would propose a plan or restructuring in accordance with the RSA's timeframe, (3) a prohibition against parties to the RSA proposing their own reorganization plan, and (4) the requirement, enforceable by an order of specific performance, that the signatories vote yes to a proposed plan that comports with the requirements of the RSA.[126] The RSA also included an out; it would only be binding upon the debtors if the court approved

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performance provisions, expressly providing that monetary damages could not compensate a breach of the agreement, meaning the creditors could not later reconsider their preliminary decision after receiving adequate information.").

[122] *See, e.g.*, DeFranceschi, *supra* note 29, at 16 ("The clear message to take from these recent bench rulings is that if you intend to use lock-up agreements in a pre-negotiated case, make sure to have fully executed lock-up agreements in hand prior to filing the case.").

[123] 486 B.R. 286 (Bankr. D. Del. 2013).

[124] *Id.* at 291-92.

[125] *Id.* at 292.

[126] *Id.*

the debtors' disclosure statement.[127] After executing the RSA, the debtors moved to approve their disclosure statement and, after approval, filed their restructuring plan with the court. At the confirmation hearing one party objected to the plan as being improperly solicited.[128]

The court overruled the objection and denied the motion to designate. In doing so, the court adopted the majority view of solicitation holding that "Congress intended that creditors have the opportunity to negotiate with debtors and amongst each other; to the extent that those negotiations bear fruit, a narrow construction of 'solicitation' affords these parties the opportunity to memorialize their agreements in a way that allows a Chapter 11 case to move forward."[129] Importantly, in so holding, the court dismissed Judge Walrath's 2002 decisions in *Stations* and *NII Holdings*, as being "of only the most limited (if any) precedential value."[130] Further, the court distinguished *Stations* and *NII Holdings*, finding that they contain a "markedly different factual and procedural context" than *Indianapolis Downs* because it was not *clear* that the debtor was soliciting votes in the case at bar.[131]

Though the *Indianapolis Downs* decision does not definitively establish that all postpetition PSAs are enforceable, the *Downs* court has indicated that when sophisticated parties are at play, courts should be hesitant to designate votes solicited in plan support agreements—

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[127] *Id.*

[128] *Id.* at 293.

[129] *Id.* at 295.

[130] *Id.* ("the Court further observes that the two-page orders entered in those cases do not contain any legal analysis and, consistent with this Court's practice, are of only the most limited (if any) precedential value.").

[131] *Id.* at 295, n. 4.

potentially quelling one area of review for PSA's.[132] Outside of Delaware, however, there is still a split of authority on the proper scope of solicitation.[133]

C. MISCELLANEOUS OBJECTIONS

The third opportunity for judicial review of plan support agreements is during the objection phase at the confirmation hearing.[134] There are only two cases in which a plan support agreement was rejected at the confirmation hearing. The first of these, *In re Bush Industries*,[135] dealt with an objection to a proposed plan subject to a lockup agreement.[136] The objectors argued that the debtor's entrance into a lockup agreement "limited the debtor's ability to seek maximum value for shareholders" and thus fails to satisfy the good faith requirement of 11 U.S.C. § 1129(a)(3).[137] Although rejecting the argument that entering into lockup agreement is a per se violation of 1129(a)(3), the court nevertheless held that because the lockup agreement provided preferential treatment for an insider, it was not "proposed in good faith" and therefore any plan subject to the agreement

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[132] Kristopher M. Hansen *et al.*, *Post-Petition Lock-Up Agreements and Designation Standards Clarified*, 32-APR AM. BANKR. INST. J. 30, 106 (2013).

[133] In New York, for instance, the Second Circuit recently rejected the "Gifting Doctrine" and applied a strict reading to the absolute priority section of 1129. *In re* DBSD N. Am., Inc., 634 F.3d 79, 85 (2d Cir. 2011). Accordingly, it is unclear whether the Second Circuit would agree with the decision in Indianapolis Downs and interpret solicitation narrowly, or like BDSD interpret the solicitation requirements strictly, to include pre-disclosure "locking up of votes". *But see, In re* Residential Capital, a recent New York State Bankruptcy Court decision where the court interpreted solicitation narrowly and refused to designate votes locked up in a postpetition PSA. No. 12-12020, 2013 WL 3286198, at *10 (Bankr. S.D.N.Y. June 27, 2013).

[134] *See e.g.*, *In re* TCI 2 Holdings, LLC, 428 B.R. 117 (Bankr. D.N.J. 2010) (raising multiple objections to the proposed plan).

[135] *In re* Bush Indus., Inc., 315 B.R. 292 (Bankr. W.D.N.Y. 2004).

[136] *Id.* at 295.

[137] *Id.* at 304.

was unconformable.[138] Similarly, in *In re TCI 2 Holdings*,[139] a proposed plan was partially rejected because an earlier plan support agreement provided impermissible third party releases to certain creditors.[140] The remaining portion of the PSA was upheld as a valid exercise of the debtor's business judgment.[141] While objections at the confirmation hearing provide solace that wrongfully approved PSAs will not necessarily be confirmed, objection to PSAs at the plan confirmation stage may be too late.[142]

Though varied, the decisions involving plan support agreements make clear that despite the various avenues for review, as long as there are sophisticated parties negotiating the transactions, it is fairly easy to get plan support agreements approved by the court—potentially leading to incongruous results.

V. POTENTIAL PROBLEMS WITH PLAN SUPPORT AGREEMENTS

To persuade a creditor that it should waive the right to sell its debt on the secondary market and lock up its vote in support of a proposed restructuring plan, it is axiomatic that the debtor must bargain away some of its own rights in exchange.[143] Without any mean-

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[138] *Id.*

[139] 428 B.R. 117 (Bankr. D.N.J. 2010).

[140] *See id.* at 138 ("The AHC/Debtor plan is confirmable only if the release of the Trump Personal Guaranty is deleted from the plan.").

[141] *Id.* at 136-37.

[142] *See infra* SECTION V(c).

[143] *See e.g.*, *In re* Innkeepers USA Trust, 442 B.R. 227, 234 (Bankr. S.D.N.Y. 2010) (outlining the various concessions made by debtor to Lehman in exchange for Lehman agreeing to sign onto the PSA, including, *inter alia*, seeking other competitive proposals, reimbursing Lehman's costs, lifting the automatic stay, and tying up excess cash if PSA is terminated).

ingful review of these bargained-for exchanges, plan support agreements have the potential to derail the bankruptcy process.[144] By locking in the terms and votes of a potential restructuring plan well before the confirmation process, PSAs may (1) destroy estate value, (2) form impermissible *sub rosa* plans, and (3) circumvent Congress's express desire for debtor's plan exclusivity.

A. DESTRUCTION OF VALUE

The first method by which a PSA may derail the bankruptcy process is by destroying estate value. Through delaying the confirmation hearing and hindering creditor negotiations, an under-reviewed plan support agreement may result in the destruction of a bankruptcy estate's value. PSA's lock the debtor and its major creditors into support of a proposed plan well before the debtor is ready to file a disclosure statement and enter the plan confirmation process. In the interim, these plans are given the court's stamp of approval through the generally lax business judgment standard of Section 363 and 365.[145] It has been routinely held that certain objections to an approval or assumption of PSAs—those predicated under Section 1129—are best left to the confirmation hearing.[146] This leaves the anomalous result where a fledgling PSA can be approved by the

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[144] *See e.g., In re* Innkeepers USA Trust, 442 B.R. at 234 (holding "that there is little basis for [the court] to conclude [that the PSA] is beneficial for the estates of the Debtors").

[145] *Infra* SECTION III.

[146] *In re* Genco Shipping & Trading Ltd., 509 B.R. 455, 468 (Bankr. S.D.N.Y. 2014) (holding that "approval of the PSA does not assure that a plan embodying its terms will be confirmed.") (*citing Residential Capital,* 2013 WL 3286198, at *2–3; *see also Innkeepers*, 442 B.R. at 236 (holding objections to plan issues were "best categorized as confirmation objections"); *In re* One Canandaigua Props., Inc., 140 B.R. 616, 618 (Bankr. W.D.N.Y. 1992) (same).

court and considered "the working plan", while simultaneously being uncomfortable at a plan confirmation hearing. It is an established precedent that "[w]hen a Chapter 11 case is not concluded quickly, debtors and their stakeholders can be grievously injured by the destruction of value."[147] A plan support agreement that is approved embodying terms that are uncomfortable inevitably elongates the bankruptcy process and causes grievous injury to the estate. The reason is twofold.

First, since the majority of the objections to a PSA are reserved for the plan confirmation hearing, the assumption/approval hearing of a PSA is superfluous and leads to an elongated stay in bankruptcy. For example, in *In re: Genco Shipping & Trading Ltd,*[148] objectors pointed out that the PSA deprived certain equity holders of their value. The court dismissed the objection, holding that objections to the confirmation of a plan are best reserved for the actual confirmation hearing.[149] Specifically, the court noted that the only thing the PSA in question does, "is allow the Debtors' prepack plan a chance to be considered for confirmation."[150] If the PSA was only meant to give the proposed plan a chance to be considered for confirmation, it begs the question as to why the debtor needs the PSA at all. Can the debtor not simply file a disclosure statement with the court and move for an up and down vote at a confirmation proceeding? Thus, the PSA in this case served to postpone the confirmation hearing by holding an assumption hearing instead. As described by Judge Chapman in *Innkeepers* "If [the debtors] believe the plan underlying the

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[147] *Genco Shipping*, 509 B.R. at 462 (citing *In re* Houghton Mifflin Harcourt Pub. Co., 474 B.R. 122, 126 (Bankr. S.D.N.Y. 2012)(citing *In re* General Motors Corp., 407 B.R. 463, 479–80, 484–85, 491, 493 (Bankr.S.D.N.Y.2009)).

[148] 509 B.R. 455 (Bankr. S.D.N.Y. 2014).

[149] *Id.* at 467.

[150] *Id.*

PSA is a good, confirmable plan, they can and should file it and prosecute it. It will either survive [various confirmation] attacks . . . —or it will not. And, if [the creditor] still wants to support the plan, it is free to do so."[151]

Second, the illusion of a court-approved plan hinders other parties from crafting their own restructuring plans, which may result in greater estate recovery. A creditor would understandably not want to expend the considerable time and energy necessary to propose an alternative plan, when the court has already given quasi-approval to a competing plan. Moreover, as one of the *Innkeepers* objectors pointed out, it is often "difficult and futile" to propose a competing restructuring plan from that embodied in the plan support agreement because the non-signatory creditors are refused access to the debtors' finances.[152] In *Innkeepers,* once the plan support agreement was rejected, a bidding process was initiated to sell the estate that significantly increased the value of the estate and creditor recovery.[153]

The confirmation hearing in *In re Bush Industries*[154] is illustrative of how an under-reviewed PSA can result in destruction of value. *Bush* involved a prepetition lockup agreement executed with seven

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[151] *Innkeepers*, 442 B.R. at 236.

[152] Capital Partners LLC To Debtors' Motion For An Order (A) Authorizing The Debtors To Assume The Plan Support Agreement And (B) Granting Related Relief, *In re* Innkeepers USA Trust, et al., No. 10-13800 (SCC) (Bankr. S.D.N.Y August 31, 2010) ECF No. 361.

[153] *Innkeepers*, 448 B.R. 131, 136 (Bankr. S.D.N.Y. 2011). (new bidding process was described as "exemplif[ying] a chapter 11 process at its best") *see also* LAW 360, *EFH Drops Restructuring Deal, Seeks Time For New Plan*, *available at* http://www.law360.com/articles/560584/efh-drops-restructuring-deal-seeks-time-for-new-plan (voluntarily scrapping the PSA because since signing certain parties have made better off than the terms embodied in the PSA).

[154] 315 B.R. 292 (Bankr. W.D.N.Y. 2004).

of the debtors' eight secured creditors.[155] After petitioning for Chapter 11 and filing a disclosure statement with the court, the lockup agreement was set-aside at the confirmation hearing. Although noting that the problems with the lockup agreement were few, the court was nonetheless required to reject the plan because it had found that a portion of the PSA was entered into in bad faith and thus violated Section 1129(a)(3) of the Bankruptcy Code.[156] The court left open the possibility of confirming an identical plan, with the defect cured.[157] In the month and a half that followed the debtor was forced to incur additional transaction costs relating to filing an amended plan,[158] preparing for an additional plan confirmation hearing,[159] and thwarting off the new objections to its plan.[160] Had the court provided meaningful review of the terms of the assumed plan support agreement at the assumption hearing, it would have recognized the problem with the agreement and avoided the costly postponement of the confirmed plan.

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[155] *Id.* at 296.

[156] *See Id.* at 307 ("It is not the function of this court to dictate the terms of a Reorganization plan. For the present, I merely rule that the plan fails to satisfy the requirements of 11 U.S.C. § 1129(a)(3), and for that reason only, cannot be confirmed.").

[157] *Id.*

[158] *See, e.g.*, Third Amended plan of Reorganization Filed by Debtor Bush Industries, Inc., Bush Industries, Inc., Docket No. 1:04-bk-12295 (Bankr. W.D.N.Y. Mar 31, 2004), (Graber, Garry) ECF No. 552.

[159] *See, e.g.*, Hearing Set (RE: related document(s)552 Third Amended Chapter 11 plan filed by Debtor Bush Industries, Inc.), Bush Industries, Inc., Docket No. 1:04-bk-12295 (Bankr. W.D.N.Y. Mar 31, 2004) ECF No. 557.

[160] *See*, *e.g.*, Objection to Confirmation of Plan Objection of Official Committee of Equity Security Holders to Debtor's Third Amended Plan of Reorganization (RE: related document(s)552 Amended Chapter 11 Plan), Bush Industries, Inc., Docket No. 1:04-bk-12295 (Bankr. W.D.N.Y. Mar 31, 2004) ECF No. 587.

B. IMPERMISSIBLE *SUB ROSA PLAN*

In addition to possibly destroying estate value, plan support agreements have the potential to form impermissible *sub rosa* plans. A *sub rosa* plan, also referred to as a de facto plan or a creeping plan of reorganization, is a transaction or sale outside the plan confirmation process that could have a significant effect on the bankruptcy estate or case.[161] The *sub rosa* doctrine was first articulated by the Fifth Circuit in its decision *In re Braniff Airways.*[162]

Braniff involved a proposed settlement agreement with PSA Airlines, dubbed the "PSA Transaction"[163] by the court. Though the court did not explicitly call the PSA Transaction a plan support agreement, the transaction did exhibit the common characteristics of plan support agreements in that it determined the terms for an eventual plan and locked up votes in favor of the plan.[164] The Fifth Circuit, reviewing the approval of the PSA Transaction under 363(b), disapproved of the transaction, holding that "[t]he debtor and the Bankruptcy Court should not be able to short circuit the requirements of chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets."[165] The court listed three factors, evident in the PSA Transaction, that led to its conclusion. First, the PSA transaction changed the composition of the debtor's assets and had "the practical effect of dictating some of the terms of any future reorganization plan."[166] Second, the transaction restricted the votes of certain creditors, which the court found

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[161] Craig A. Sloane, *supra* note 10, at 37.
[162] 700 F.2d 935 (5th Cir. 1983).
[163] Not to be confused with plan support agreement.
[164] Craig A. Sloane, *supra* note 10, at 37 (citing *Brainiff*, 700 F.2d at 940).
[165] *Brainiff*, 700 F.2d at 940.
[166] Craig A. Sloane, *supra* note 10, at 37 (citing *Brainiff*, 700 F.2d at 939-940).

to be outside the scope of a 363 transaction.[167] Last, certain releases promised in the transaction were also held to be outside the scope of 363.[168]

By circumventing the procedural protections afforded in the plan confirmation process, a *sub rosa* plan presents a host of problems to those creditors not included in potential PSAs. For instance, through the use of a PSA, a creditor may be able to "bypass the requirements of Chapter 11" and strong-arm a debtor into providing itself with a windfall at the expense of the other creditors.[169] Absent the PSA, the plan confirmation process, specifically the "fair and equitable treatment" requirements of the Section 1129, would typically guard against these scenarios. [170] As described in *Brainiff*, *sub rosa* plans can also deleteriously "(1) dictate[d]the terms of any future reorganization plan, (2) disenfranchise[d] creditor voting in the plan process, (3) alter[ed] creditors rights, (4) dispose[ed] of highly significant assets, sometimes referred to as "crown jewels," and (5) release[d] claims against the debtor."[171]

Although *sub rosa* plans are generally prohibited in the context of sales under Section 363, because an assumption of a PSA encom-

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[167] *Id.* It is now par for the court that 363 transactions can lockup creditor's votes. *See e.g. See, e.g., In re* Indianapolis Downs, LLC., 486 B.R. 286, 293 (Bankr. D. Del. 2013) (denying motion to designate votes locked up before a disclosure statement was filed as part of debtors restructuring support agreement).

[168] *Id.*

[169] *See In re* Chrysler LLC, 576 F.3d 108, 116 (2d Cir.) *cert. granted, judgment vacated sub nom*. Indiana State Police Pension Trust v. Chrysler LLC, 558 U.S. 1087, 130 S. Ct. 1015, 175 L. Ed. 2d 614 (2009) and *vacated sub nom*. *In re* Chrysler, LLC, 592 F.3d 370 (2d Cir. 2010) (noting that there are critics of 363 sales that comprise "reorganization[s] in all but name, achieved by stealth and momentum").

[170] 11 U.S.C. 1129(b)(1); *see also In re* Braniff Airways, Inc., 700 F.2d 935, 939-940 (5th Cir. 1983) (disapproving of agreements that provide distribution to unsecured creditors before the secured creditors are paid in full).

[171] Craig A. Sloane, *supra* note 10, at 37.

passes the same concerns as those brought up by the courts in connection with 363 sales—i.e. the plan support agreement will "short-circuit" the requirements and protections of the plan confirmation process—the same analysis should apply to the assumption of plan support agreements under Section 365.[172] For example, the objectors in *In re MPM Silicones* alleged that the plan support agreement entered into by the debtor constituted a *sub rosa* plan because it impermissibly distributed equity in the debtor prior to the approval of a disclosure statement—thereby eluding the oversight of the Chapter 11 process.[173] Similarly, in *Innkeepers* the court was concerned over the "rush" in which the Innkeepers' PSA was entered into and the irregular fashion by which the debtor shopped the agreement to its various creditors.[174]

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[172] However, it can be argued that because PSAs simply provide a blueprint of a proposed plan that can later be rejected and modified at the confirmation hearing, they are distinct from 363 sales, which all but foreclose the opportunity to object after the sale has gone through. *See e.g. In re* Bush Indus., Inc., 315 B.R. 292, 304 (Bankr. W.D.N.Y. 2004) (rejecting the PSA at the plan confirmation hearing, and failing to confirm the proposed plan).

[173] Objection Of Fortress Investment Group LLC To Debtors' Motion For Orders (I) Authorizing The Debtors To Assume The Restructuring Support Agreement And (Ii) Authorizing And Approving The Debtors' (A) Entry Into And Performance Under The Backstop Commitment Agreement, (B) Payment Of Related Fees And Expenses, And (C) Incurrence Of Certain Indemnification Obligations, *In re*: MPM Silicones, LLC, et al., No. 14-22503 (Bankr. S.D.N.Y. Apr 13, 2014) ECF No. 330.

[174] *In re* Innkeepers USA Trust, 442 B.R. 227, 233 (Bankr. S.D.N.Y. 2010) (rejecting the debtors' motion to assume a PSA under Section 365).

C. BYPASSES DEBTOR EXCLUSIVITY

The third problem with rubberstamping plan support agreements is that a PSA may have the effect of forfeiting a debtor's exclusivity.[175] It is undisputed that a debtor is given 120 days at the commencement of a bankruptcy case to exclusively file a plan of reorganization with the court.[176] This exclusivity period was enacted by Congress to give the debtor an opportunity to negotiate with all of its creditors and shareholders and eventually reach a consensual and successful restructuring plan.[177] A plan support agreement that ties down a debtor into support of a plan that is not supported by all of its creditors hinders this free flow of negotiations and is tantamount to a waiver of the debtors' exclusivity.[178] This problem is particularly acute when the PSA is executed between the debtor and only a few of its most powerful creditors. As described in *Innkeepers*, PSAs of this fashion "breed[s] contempt rather than fostering [the] negotiations" that were intended by Congress in their enactment of the debtor's exclusivity period.[179]

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[175] *See e.g.*, Official Comm. of Unsecured Creditors of New World Pasta Co. v. New World Pasta Co., 322 B.R. 560, 569 (M.D. Pa. 2005) ("the Committee asserts that Section 5.13 restricts the Debtors' rights with regard to the filing of its plan of reorganization under section 1121, by effectively (1) granting the Prepetition Senior Lenders the Debtors' exclusivity rights, and (2) abandoning the Debtor's right to ever file a plan of reorganization without the Prepetition Senior Lenders' consent.").

[176] 11 U.S.C. § 1121(b) (2014).

[177] *Innkeepers*, 442 B.R. at 234.

[178] *See e.g., Id.* ("The PSA has had such an effect on the Debtors' estates by tying all parties to a plan which lacks support from nearly the entire capital structure and preventing the Debtors from negotiating in good faith with their numerous constituents who will eventually be required to vote on a plan.")

[179] *Id.*

VI. CONCLUSION

Plan support agreements are valuable tools in the world of complex restructurings. They provide solace to both the debtor and its creditors that they are not negotiating a restructuring plan in vain. Through locking up the votes of the creditors and requiring a debtor to propose a bargained for plan, plan support agreements can help hasten the bankruptcy process. At the same time, however, the majority of plan support agreements are assumed or approved in rubberstamped transactions with little or no meaningful review by the court. Though most PSAs are executed for the benefit of the debtor and its constituents, there are some instances where an approved plan support agreement may cause a problem for the bankruptcy estate. To avoid these complications, courts should pay more mind to the terms embodied in plan support agreements before signing off on them.