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Indy Downs: Lock-Up Agreements Are A Valuable Tool



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Law360, New York (February 08, 2013, 1:30 PM ET) -- On Jan. 31, 2013, the bankruptcy court for the District of Delaware issued an opinion that approved the confirmation of the proposed plan in In re Indianapolis Downs LLC. The Indianapolis Downs opinion provided substantial guidance on the permissibility of post-petition "lock-up" agreements — an area of prior uncertainty, particularly in Delaware.[1] Also referred to as restructuring support agreements or plan support agreements, such agreements provide that if a plan contains certain terms then the parties to the agreement will support the plan. These agreements are often critical in ensuring that the constituents who negotiate a plan actually vote for the plan.

Judge Brendan Shannon found that such agreements do not require, nor are they likely to cause, designation (disallowance) of the votes of the parties thereto for or against a plan of reorganization. In so ruling Judge Shannon distinguished and found not precedential certain prior Delaware cases that had suggested post-petition lock-up agreements may constitute an invalid post-petition solicitation that would support disallowance of the votes of the parties to such agreements.

Pursuant to Section 1125 of the Bankruptcy Code, solicitation of acceptance or rejection of a plan after the commencement of a bankruptcy case can only occur following the distribution of a written disclosure statement approved by the bankruptcy court as containing "adequate information" to permit creditors to make an informed decision on the plan. The term "solicitation" is not defined in the Bankruptcy Code and courts have varied in how broadly they interpret the term. It is clear, at least in the Third Circuit, that merely presenting a draft plan but not requesting a vote on such plan does not constitute an improper "solicitation" and that the term "solicitation" should generally be interpreted narrowly.[2] Section 1126(e) of the Bankruptcy Code provides a penalty for failing to comply with the solicitation rules by stating that "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."

A number of courts have found that requesting a vote on a plan prior to the approval and distribution of the accompanying disclosure statement constitutes an improper solicitation and provides grounds for disallowance of any votes received under Section 1126(e) — thus materially inhibiting a Chapter 11

debtor's ability to enter into "lock-up" agreements with creditors following the commencement of the case. Indeed, the bankruptcy court for the District of Delaware considered this very issue in two unpublished opinions in 2002, in the matters of In re Stations Holdings Co. and In re NII Holdings. Inc., and in each case disallowed the votes of creditors that had entered into post-petition lock-up agreements on the grounds that an agreement regarding how the creditor would vote on a plan prior to the approval of a disclosure statement was solicitation in violation of Section 1125 and punishable by disallowance of the votes under Section 1126.[3]

Yet, certain other courts have found that post-petition lock-up agreements fall short of a solicitation. For example, in In re Heritage Organization LLC,[4] the bankruptcy court for the Northern District of Texas found that a post-petition lock-up agreement did not constitute an impermissible solicitation where (1) the agreement did not provide for specific performance if the parties failed to vote for the plan and (2) the parties to the agreement were co-proponents of the plan — thus clearly well informed of the facts of the case despite not having received a written disclosure statement approved under Section 1125 prior to entering the post-petition lock-up agreement.[5]

Despite the significance of the issue, the case law on the permissibility of post-petition lock-up agreements remains sparse and conflicted. However, the decision issued in Indianapolis Downs should provide great comfort that negotiating and entering into post-petition lock-up agreements in cases pending in the District of Delaware will not be considered improper solicitations or lead to disallowance of the parties' votes.

In Indianapolis Downs the debtors and certain of the debtors' principal secured creditors entered into a restructuring support agreement which memorialized an agreement on the principal terms of the debtors' restructuring process and plan a little more than a year after the cases were commenced but prior to the approval of a disclosure statement by the bankruptcy court. Notably, the restructuring support agreement provided for (1) specific terms of the plan of reorganization to be proposed, (2) a time frame for the debtors to pursue the plan, (3) a prohibition on the parties to the restructuring support agreement from proposing or supporting a competing plan and (4) the requirement that the parties vote for the plan and a remedy of specific performance if such parties failed to vote for the plan.

Although the debtors did not seek the bankruptcy court's authority to enter into the restructuring support agreement prior to executing the document, the debtors did seek subsequent approval of the restructuring support agreement as part of the debtors' motion to approve their disclosure statement. While the bankruptcy court approved the disclosure statement and the method of entering into the restructuring support agreement, at the time of such approval the bankruptcy court reserved judgment on the effect and consequences of the restructuring support agreement on plan confirmation and the status of the votes of the parties to the agreement.

In the days leading up to the confirmation hearing on the debtors' proposed plan, certain other parties in interest, relying heavily on In re Stations Holdings Co. and In re NII Holdings. Inc., filed a motion to disallow the votes of the signatories to the restructuring support agreement on the grounds that the entry into the restructuring support agreement was an improper solicitation in violation of Section 1125. The debtors and the parties to the restructuring support agreement, in turn, relied in large part on In re Heritage Organization LLC, arguing that disallowance of the votes was neither required nor appropriate.

Approximately three months after a two-day evidentiary hearing regarding the confirmation of the debtors' plan and a corresponding sale of assets, the bankruptcy court, in a twenty eight page opinion, confirmed the plan and denied the motion to disallow the votes of the signatories to the restructuring support agreement.

Judge Shannon found that the holdings in In re Stations Holdings Co. and In re NII Holdings, Inc., which were each pre-packaged cases, "present a markedly different factual and procedural context than the

case at bar" and "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."[6]

Instead, Judge Shannon found "the analysis and reasoning in In re Heritage Organization LLC dispositive" and 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."[7]

Moreover, Judge Shannon explained that "[d]esignation of votes in this case would be demonstrably inconsistent with the purposes of the Bankruptcy Code" because "creditor suffrage is a bedrock component of Chapter 11" and "it would be anomalous, in the absence of a showing of bad faith or wrongful conduct, to discount or ignore the votes of the overwhelming majority of the creditors and stakeholders" and deny confirmation of the plan.[8]

Further, Judge Shannon stated that the "interests that § 1125 and the disclosure requirements are intended to protect are not at material risk in this case."[9] Noting that the parties to the restructuring support agreement were "all sophisticated financial players and have been represented by able and experienced professionals throughout these proceedings," Judge Shannon reasoned that it would "grossly elevate form over substance to contend that § 1125(b) requires designation of their votes because they should have been afforded the chance to review a court-approved disclosure statement prior to making or supporting a deal with the Debtor."[10]

Judge Shannon further reasoned that the "decision whether to designate a creditor's ballot is within the sound discretion of the Court" and that in "situations where creditors have acted with the apparent goal of furthering their own self-interest and maximizing their recoveries, courts have been extremely reluctant to penalize such parties through designation."[11] In light of these facts, Judge Shannon held that disallowance of the votes of the parties to the restructuring support agreement was "neither required nor warranted."[12]

In particular, Judge Shannon found that the requirement that the parties to the restructuring support agreement vote for the plan, and the provision of specific performance to enforce such a commitment, was "not dispositive" and that the parties "negotiated a deal and memorialized it" in the restructuring support agreement which predictably "contained a commitment to vote for a plan that embodied that deal."[13]

Indeed, Judge Shannon summarized that "the filing of a Chapter 11 petition is an invitation to negotiate" and that "courts must be chary of construing those disclosure and solicitation provisions [of the Bankruptcy Code] in a way that chills or hamstrings the negotiation process that is at the heart of Chapter 11."[14] Thus, when "a deal is negotiated in good faith between a debtor and sophisticated parties, and that arrangement is memorialized [by] a written commitment and promptly disclosed, § 1126 will not automatically require designation of the votes of the participants."[15]

The holding in Indianapolis Downs should provide substantial comfort to creditors negotiating the terms of a potential plan with debtors following the petition date. As long as such creditors are negotiating in good faith and in their own self-interest, then such negotiations, or the execution of an agreement memorializing them, should not result in disallowance of their votes in the bankruptcy courts in the District of Delaware.

Simultaneously, the holding permits debtors negotiating the terms of a restructuring support agreement to include the remedy of specific performance for a creditor failing to vote in accordance with the terms of a restructuring support agreement. As a result, it seems likely that Judge Shannon's holding will ultimately encourage fulsome negotiations between debtors and creditors of the terms of a plan prior to

the filing of the plan itself, and perhaps lead to greater certainty in the plan process in many cases.

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Latham & Watkins represents the lender to the purchaser of substantially all of the debtors' assets in this matter

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[1] Case No. 11-11046.

[2] In re Century Glove, Inc. v. First American Bank of New York, 860 F.2d 94 (3d Cir. 1988).

[3] In re Stations Holding Company, Case No. 02-10882 (Bankr. D. Del. Sept. 25, 2002) (MFW); In re NII Holdings, Case No. 02-11505 (Bankr. D. Del. Oct. 22, 2002) (MFW).

[4] 376 B.R. 783 (Bankr. N.D. Tex. 2007)

[5] See also In re Kellogg Square P'Ship, 160 B.R. 336 (Bankr. D. Minn. 1993).

[6] In re Indianapolis Downs, LLC, Case No. 11-11046 (Bankr. D. Del. Jan. 31, 2013), p. 9.

[7] Id.

[8] Id.

[9] Id.at 10.

[10] Id.

[11] Id. at 11.

[12] Id.

[13] Id.

[14] Id.

[15] Id.