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By Luke A. Barefoot, Camisha L. Simmons and Brad Lenox[1]

Plan-Support Agreements: Uncertainty Abounds

Coordinating Editor Luke A. Barefoot
Cleary Gottlieb Steen & Hamilton LLP
New York

Coordinating Editor Camisha L. Simmons
Simmons Legal PLLC
Dallas

Brad Lenox
Cleary Gottlieb Steen & Hamilton LLP
New York

It is common in "prepackaged" or "prenegotiated" bankruptcies for a debtor to execute an agreement by which creditors agree to vote in favor of a reorganization plan. The popularity of such agreements (whether called "lock-up," "plan-support" or "restructuring-support" agreements) is not surprising given that they minimize disputes (and costs), speed up the restructuring process, and provide all interested parties certainty and predictability. Although many plan-support agreements (PSAs) are entered into pre-petition, *post-petition* voting arrangements are attractive for the same reasons. In 2003, the U.S. Bankruptcy Court for the District of Delaware issued two bench rulings designating creditor votes made pursuant to post-petition PSAs. Subsequently, courts have been unable to reach a consensus on whether votes made pursuant to such post-petition agreements constitute impermissible "solicitation" under § 1125(b) of the Bankruptcy Code.

Courts continue to disagree on whether post-petition PSAs are permissible. Indeed, two judges in the U.S. Bankruptcy Court for the Southern District of New York (SDNY) recently arrived at opposite decisions in the *SAS AB* and *Aeroméxico* bankruptcies. If left unresolved, this uncertainty could limit a debtor's options in enforcing post-petition PSAs and may influence a debtor's choice of venue.

Background

In addition to the *SAS AB* and *Aeroméxico* opinions, there are three prominent opinions involving PSAs. These cases, further described *infra*, illustrate judicial concerns surrounding plan-support provisions, specifically the appropriate scope of "solicitation" under § 1125(b) and its policy goals.

Heritage Org.

In *Heritage Org.*,[2] a U.S. Bankruptcy Court for the Northern District of Texas case, certain creditors moved to designate the votes of parties to a post-petition PSA with the debtors on the following grounds: (1) the debtors improperly solicited those votes in violation of § 1125(b); and (2) based on the decisions in *In re Stations Holding Co.* and *In re NII Holdings*,[3] debtors are *per se* prohibited from executing post-petition PSAs with creditors prior to solicitation of a court-approved disclosure statement.[4]

In denying the motion to designate, Hon. **Barbara J. Houser** (now retired) held that based on the facts before her, § 1125 could not be read such that entry into the PSAs at issue constituted improper solicitation. She agreed with other courts, including the Third Circuit Court of Appeals in *Century Glove*,[5] which held that "solicitation" under § 1125 must be read narrowly to refer only to a "specific request for an official vote" on a plan. Further, the agreement and its associated term sheets did not constitute such a "specific request," but were rather "the written memorialization of the negotiations towards settlement of the legal disputes that have prevented confirmation to date, and of the negotiations toward confirmation of a plan."[6] In this way, Judge Houser further echoed *Century Glove* by concluding that the PSA, rather than impermissible *solicitation*, was better characterized as *negotiations* permitted under § 1125.

1 This article represents the views of the authors, and such views should not necessarily be imputed to Cleary Gottlieb Steen & Hamilton LLP, Simmons Legal PLLC or its respective affiliates and clients. Cleary Gottlieb Steen & Hamilton LLP represents the debtors in *In re LATAM*.

2 *In re Heritage Org. LLC*, 376 B.R. 783 (Bankr. N.D. Tex. 2007).
3 *In re Stations Holding Co.*, Case No. 02-10882 (MFW), (Bankr. D. Del. Sept. 25, 2002); *In re NII Holdings Inc.*, Case No. 02-11505 (MFW) (Bankr. D. Del. Oct. 22, 2002).
4 *Id.* at 785, 788.
5 *Century Glove Inc. v. First Am. Bank of New York*, 860 F.2d 94 (3d Cir. 1988).
6 *Heritage Org.*, 376 B.R. at 792 (quoting *In re Owens Corning*, 419 F. 3d 195 (3d Cir. 2005)).

The court also found that § 1125 did not *per se* prohibit post-petition, pre-disclosure statement PSAs. Judge Houser distinguished *NII Holdings* and *Stations Holdings* because the agreements at issue there provided for specific performance in the event of a breach such that creditors were "stripped of the Bankruptcy Code's protections against the harm caused by solicitation without court-approved, adequate information."[7] Moreover, the parties before her were themselves *co-proponents* of the filed plan, so Judge Houser found that votes cast pursuant to the PSA did not run afoul of § 1125's goal: ensuring that creditors were informed enough to act in their own interests.[8]

Indianapolis Downs

Similarly, in *Indianapolis Downs*,[9] Hon. **Brendan Linehan Shannon** denied a motion to designate the votes of certain creditors that executed a post-petition restructuring support agreement (RSA) with the debtors prior to the filing of a disclosure statement.[10] The RSA memorialized months of negotiations between the debtors and certain of their significant creditors, including the terms of a subsequently filed plan.[11] Pursuant to the RSA, signatory creditors agreed to vote for any plan that complied with the terms of the RSA, which commitment was enforceable by specific performance.[12] Following execution, the debtors publicly filed — but did not seek court approval of — the RSA simultaneously with the proposed plan and disclosure statement, which described the RSA in detail.[13]

Luke Barefoot is a partner and Brad Lenox is an associate with Cleary Gottlieb Steen & Hamilton LLP in New York. Camisha Simmons is the managing member of Simmons Legal PLLC in Dallas.

Relying on *Heritage Org*., Judge Shannon found that vote designation would be inconsistent with the purposes of § 1125, which was designed to prevent the solicitation of votes at a time when creditors are "too ill-informed to act capably in their own interests."[14] Because the RSA parties were sophisticated and well-represented (although not proponents of the plan themselves, as in *Heritage Org*.), it would "grossly elevate form over substance" to designate their votes merely because the RSA had been executed prior to approval of a disclosure statement.[15] Also citing to cases such as *Century Glove*, Judge Shannon reasoned that because Congress intended that creditors have the opportunity to negotiate with debtors and among each other, "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."[16] Judge Shannon also warned that courts should be wary of construing the Code's disclosure and solicitation provisions "in a way that chills or hamstrings the negotiation process that is at the heart of Chapter 11."[17]

Based on the foregoing, Judge Shannon denied the motion. Because the RSA reflected a good-faith negotiated deal between sophisticated parties, he noted that it "predictably" contained a commitment to vote for a plan that embodied that deal.[18] If the plan had differed materially from what was contemplated by the RSA parties, there would be no obligation to vote in favor of it.[19]

ResCap

In *ResCap*,[20] the debtors moved for court approval of a post-petition, pre-disclosure PSA between the debtors and certain of their creditors.[21] This PSA required the parties, each of which had been active in the matter since the initial filing, to support a plan consistent with the terms of this PSA and its associated term sheets.[22] A number of interested parties filed objections to this PSA, although Hon. **Martin Glenn**'s opinion did not reference any objection on the basis of § 1125.

Consistent with *Heritage Org*. and *Indianapolis Downs*, Judge Glenn noted that courts, namely *Century Glove*, have read solicitation narrowly and that PSAs have "generally been approved by courts in this and other districts."[23] He then held that this PSA did not constitute an improper "solicitation" under § 1125, because although this PSA obligated creditors to vote in favor of a plan, there were numerous termination events, and no party agreed to vote unless and until the court approved a disclosure statement and their votes had been properly solicited pursuant to § 1125.[24]

Recent SDNY Cases

Aeroméxico

At a Nov. 16, 2021, hearing, Hon. Shelley Chapman (now retired) granted the *Aeroméxico*[25] debtors' motion to approve certain agreements assuming and settling claims filed by certain aerospace counterparties. The creditors' committee had objected to the motion, arguing that the included plan-support provisions constituted impermissible post-petition solicitation under § 1125.[26] The creditors' committee reasoned, among other things, that support for the plan was "not a business term in coming to these settlements" (*i.e*., permissible negotiation under

7 *Id.* at 793.
8 *Id.* at 794.
9 *In re Indianapolis Downs LLC*, 486 B.R. 286 (Bankr. D. Del. 2013).
10 *Id.* at 291.
11 *Id.* at 292.
12 *Id.*
13 *Id.*
14 *Id.* at 295-96 (quoting *In re Clamp-All Corp.*, 233 B.R. 198, 208 (Bankr. D. Mass. 1999)).
15 *Id.* at 296.
16 *Id.* at 295.
17 *Id.* at 297.
18 *Id.* at 296.
19 *Id.* at 296-97.
20 *In re Residential Cap. LLC*, No. 12-12020, 2013 WL 3286198 (Bankr. S.D.N.Y. June 27, 2013).
21 *Id.* at *2-3.
22 *Id.* at *16-17.
23 *Id.* at *20.
24 Judge Glenn also noted that the PSA was an exercise of the debtors' sound business judgment, as it was the culmination of more than a year of contentious proceedings and months of mediation. *Id.* at 7-8.
25 Transcript of Hearing, *In re Grupo Aeroméxico, S.A.B. de C.V.*, No. 20-11563-SCC (Bankr. S.D.N.Y Nov. 16, 2021).
26 *Id.* at 33:2-18.

Century Glove) but rather a "throw-in."[27] Judge Chapman disagreed and found that there was no Code violation. Her analysis focused largely on the fact that each creditor was a sophisticated actor represented by counsel who made an "economic decision" as to whether to agree to the support provision in their negotiations, similar to the *Indianapolis Downs* court's analysis.[28] Judge Chapman also explained that the included plan-support provisions added value to the debtors' estates because they streamlined the plan process through the settlement of claims.[29]

SAS

Most recently, in September 2022,[30] the debtor, SAS AB, sought court approval to enter into and perform under certain labor agreements an RSA with certain of its pilot unions. The agreements, which included as a settlement term allowance of a claim against the debtor, resolved certain litigation filed by the unions at an expected cost savings of approximately $200 million.[31] No objections were filed.

Hon. **Michael E. Wiles**, in contrast to Judge Chapman's ruling a little over a year earlier, *sua sponte* raised "concerns" about the debtor's use of the term "RSA" because it did not "even remotely resemble anything that I've ever seen as an RSA and certainly is not of the kind of agreement that Courts have allowed under the *Indianapolis Downs* case [or] the *ResCap* case."[32] Specifically, Judge Wiles took issue with the fact that the agreement did not describe any particular plan terms such that the arrangement "could be used in a sense to buy a large almost inflated vote in exchange for reduced distribution."[33]

Judge Wiles denied the motion, finding that the agreement was "just a flagrant violation of Section 1125(b)" because the plan-support provisions constituted an impermissible solicitation.[34] Because no plan was yet on file, nor were the material plan terms described in the RSA, Judge Wiles held that the debtor could not rely on the more narrow definition of "solicitation," which is distinguished from "negotiation" as described in *Century Glove*.[35] Similarly, because the creditor made an agreement to vote in the absence of any discussed plan terms (other than allowance and recovery of their claims), the pilot unions had no choice but to vote in favor of "whatever [the debtor may] choose to do at a later date" and had no rights to back down after reviewing the disclosure statement.[36]

Key Takeaways

Excessively broad readings of "solicitation" in the context of post-petition PSAs could result in the chilling effects noted in *Century Glove*. Indeed, the Third Circuit held that there was "no principled, predictable difference between negotiation and solicitation of future acceptances" and rejected "any definition of solicitation which might cause creditors to limit their negotiations."[37] Notwithstanding its ultimate treatment by a court, one can appreciate certain similarities between the RSA in *SAS* and the agreements in *Heritage Org*., *Indianapolis Downs*, *ResCap* and *Aeroméxico*. In each of these cases, such agreements were entered into prior to the filing of a plan and disclosure statement. Although those agreements included more detailed plan-related terms, the courts did not rest their approval of the agreements (or the denial of designation of votes) solely on those facts. Instead, the courts focused more on the policy behind § 1125 and the protections that the Bankruptcy Code intends for creditors.

> **[C]onsidering the rising costs of in-court restructurings, uncertainty around the permissibility of post-petition PSAs may limit the abilities of debtors to negotiate with their creditors in a freefall bankruptcy.**

Where parties are represented by sophisticated counsel and have an active involvement in a chapter 11 case, the risk that such a creditor is "too ill-informed to act capably in their own interests"[38] is minimal. In this way, Judge Chapman's reasoning that the decision to enter into an agreement with a plan-support provision *is itself* an economic choice resulting from a good faith-negotiation is more consistent with the cases discussed herein. Further, Judge Wiles's concern over agreements without detailed plan terms (or that are not explicitly conditioned on the approval of a complying plan) is mitigated, given that common law contractual or equitable remedies would be available to signatories in such instances, as the court in *Heritage Org*. noted.

Finally, considering the rising costs of in-court restructurings, uncertainty around the permissibility of post-petition PSAs may limit the abilities of debtors to negotiate with their creditors in a freefall bankruptcy. It could also lead to costly, drawn-out plan-confirmation disputes. At the extreme, to the extent that the inconsistent positions taken by different judges persist, potential debtors who are unable to pursue a prenegotiated or prepackaged plan may weigh that factor when choosing their venue.[39] abi

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27 *Id.* at 37:10-11.
28 *Id.* at 39:22-24.
29 *Id.* at 41:16-18. Judge Chapman subsequently reiterated her position after a claims-purchaser raised similar challenges to plan-support provisions in agreements between the *Aeroméxico* debtors and certain labor unions.
30 Transcript of Hearing, *In re SAS AB*, No. 22-10925-MEW (Bankr. S.D.N.Y Sept. 28, 2022) (the "SAS Tr.").
31 *Id.* at 8:20-24.
32 *Id.* at 17:21-24.
33 *Id.* at 10:13-14.
34 SAS Tr. at 22:23-24.
35 *Id.* at 9:24-10:9.
36 *Id.* at 20:25.
37 *Century Glove*, 860 F.2d at 101-02.
38 *Indianapolis Downs*, 486 B.R. at 295-96.
39 *See* Robert J. Keach, "A Hole in the Glove: Why 'Negotiation' Should Trump 'Solicitation,'" *ABI Journal* (June 2003), at 22, *available at* abi.org/abi-journal (*e.g.*, in reference to Delaware, it was noted that "some trumpeted [certain] decisions as ending Delaware's run as a haven for pre-packaged or pre-negotiated plans, or indeed as the venue of choice for chapter 11 cases generally").