ALERT
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BANKRUPTCY, INSOLVENCY & RESTRUCTURING
News Concerning Recent Bankruptcy Decisions

COZEN O'CONNOR

Bankruptcy Court for the District of Delaware Approves the Use of Post-Petition Lock-Up Agreements and Permits Release of Non-debtor Parties by Non-voting Creditors

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The Delaware Bankruptcy Court recently issued an opinion in the *Indianapolis Downs*[1] Chapter 11 case that is worth reading in its entirety for its impact on numerous plan confirmation issues. This article will address the court's endorsement of post-petition lock-up agreements and, secondarily, the court's approval of a plan's third-party release provision that provides for the deemed consent of non-voting creditors.

Lock-up agreements are contracts generally negotiated between a debtor (or a prospective debtor) and a creditor in which a creditor promises to vote in favor of a plan of reorganization so long as certain agreed upon terms are included in the plan. Usually, lock-ups are entered into prepetition as part of a prepackaged Chapter 11 reorganization. However, in certain cases, lock-ups are negotiated after a debtor files for bankruptcy but prior to the distribution of an approved disclosure statement or an actual plan.

Plan objectors have argued that these post-petition lock-ups constitute improper "solicitations" for the acceptance of a plan, claiming such agreements are entered into without providing the parties to the agreement with an approved disclosure statement as required by Section 1125(b) of the Bankruptcy Code.[2] In 2002, two unreported Delaware Bankruptcy Court rulings issued in the *Stations Holding* and *NII Holdings'* bankruptcies agreed and determined that the lock-up agreements in those cases constituted improper solicitations in violation of Section 1125(b) of the Bankruptcy Code.[3] Accordingly, in *Stations Holding* and *NII Holdings*, the Bankruptcy Court "designated" the locked-up votes under Section 1126(e) of the Bankruptcy Code[4] and, thus, did not count them in determining whether to confirm the proposed plan.[5]

However, in *In re Indianapolis Downs, LLC*, the Bankruptcy Court declined to follow the rulings issued in *Stations Holding* and *NII Holdings* and refused to designate the votes cast in favor of the debtors' plan by parties who had entered into a post-petition agreement requiring them to vote in favor of a conforming plan.[6] In so holding, the Delaware Bankruptcy Court has disagreed with the *Stations Holding* decision, which presented somewhat similar facts, and offered a thoughtful view of the setting in which post-petition plan support agreements would be approved.

FACTUAL BACKGROUND

Prior to filing for bankruptcy, Indianapolis Downs, LLC (Indianapolis Downs) and Indiana Downs Capital Corp., (Indiana Downs) attempted to negotiate a restructuring agreement with their creditors to resolve the companies' looming financial crises. Unfortunately, these negotiations failed and both Indianapolis Downs and Indiana Downs filed Chapter 11 petitions on April 7, 2011.

After filing for bankruptcy, the debtors[7] and the majority of their creditors continued to negotiate over the debtors' restructuring. Following months of negotiations and litigation, the parties reached an agreement and entered into a Restructuring Support Agreement (RSA) that outlined the process by which the debtors would reorganize. The RSA included a "requirement (enforceable by an order of specific performance) that parties to the RSA vote 'yes' for a plan that complies with the RSA."[8]

On April 25, 2012, the RSA was filed with the Bankruptcy Court along with a plan of reorganization and an accompanying proposed disclosure statement that detailed the RSA. Subsequently, after finding a purchaser for substantially all the debtors' assets (as contemplated by the RSA), the debtors simultaneously requested confirmation of their plan and approval for the sale. However, certain of the debtors' senior management and holders of equity and debt instruments objected to confirmation of the plan. Among other things, the objectors asked the Bankruptcy Court to designate the votes cast in favor of the plan by those who were bound by the RSA,

claiming that the RSA "constituted a wrongful post-petition solicitation of votes on a plan prior to Court approval of a disclosure statement."[9]

ENTERING INTO POST-PETITION LOCK-UP DOES NOT REQUIRE DESIGNATION OF A BOUND PARTY'S VOTE IN FAVOR OF A CONFORMING PLAN

At the outset, Judge Shannon declined to follow the orders entered in the *Stations Holding* and *NII Holdings* bankruptcy cases, concluding that those cases were distinguishable and "are of only the most limited (if any) precedential value" due to their containing no legal analysis.[10] Instead, Judge Shannon decided to follow the reasoning of *In re Heritage Org., L.L.C.*, an opinion that declined to designate the votes of creditors who were subject to a post-petition lock-up agreement because designation of such votes "would not further any bankruptcy policy."[11] As Judge Shannon explained, "the right of creditors to vote on a plan is a critical feature of Chapter 11 . . .."[12] In the absence of bad faith or wrongful conduct, it would be inconsistent with the purposes of the Bankruptcy Code to "discount or ignore the votes of the overwhelming majority of the creditors and stakeholders, and thereby deny confirmation of a Plan that has been laboriously (and expensively) developed and has won broad support."[13] Additionally, "and perhaps more to the point," the disclosure requirements of Section 1125(b) of the Bankruptcy Code were not meant to protect sophisticated financial players such as the parties to the RSA.[14] "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."[15]

With these principals in mind, Judge Shannon turned to the facts of the case to determine whether, in the exercise of his discretion, designation of the RSA parties' votes would be appropriate. Judge Shannon found it significant that the parties to the RSA "were acting at all times to maximize their own recoveries . . .."[16] When parties are acting in their own self-interest, "Courts have been extremely reluctant to penalize such parties through designation."[17] Furthermore, the fact that the RSA contained a remedy of specific performance if the RSA parties did not vote in favor of a conforming plan did not require designation. "In the event the Debtors' proposed Plan differed materially from what was contemplated by the [RSA parties], obviously they would not be obligated to vote for it."[18] Therefore, consistent with the 3rd Circuit's goal of "construing [] disclosure and solicitation provisions in a way that [does not] chill[] or hamstring[] the negotiation process that is at the heart of Chapter 11," Judge Shannon denied the plan objectors' motion to have the votes of the parties to the RSA designated.[19]

NON-VOTING CREDITORS ARE BOUND BY THIRD-PARTY RELEASE PROVISION

Having dispensed with the plan objectors' designation request, Judge Shannon turned to, among other things, an objection to the plan's third party release provision. Under the debtors' plan, unimpaired creditors who were deemed to have accepted the plan, creditors who voted for the plan but did not check a box on the ballot indicating their desire to opt out of the third-party release, and creditors who abstained from voting and did not otherwise indicate their desire to opt out of the third party release provision were all deemed to have consented to the release provision. The U.S. Trustee objected to the provision, arguing that "the Third Party Release is unenforceable without affirmative consent."[20] Disagreeing, Judge Shannon stated that there is "no such hard and fast rule."[21] In this case, the deemed acceptance by the unimpaired creditors was permissible because "these creditors are being paid in full and have therefore received consideration for the releases. As for those *impaired* creditors who abstained from voting on the Plan, or who voted to reject the Plan and did not otherwise opt out of the releases, the record reflects these parties were provided detailed instructions on how to opt out, and had the opportunity to do so by marking their ballots. Under these circumstances, the Third Party Releases may be properly characterized as consensual and will be approved."[22]

VIEWPOINT

Indianapolis Downs is a notable decision for its discussion of many plan confirmation issues. With regards to the effectiveness of post-petition lock-up agreements, the case law remains limited and conflicting. However, *Indianapolis Downs* should be viewed as strong support for the use of post-petition lock-up agreements as a way to negotiate for support of a confirmable Chapter 11 plan in Delaware bankruptcy cases among sophisticated and well represented parties. To minimize the chance of votes being designated, debtors, creditors and other

stakeholders who are contemplating entering into a post-petition lock-up agreement should be mindful that the parties to the agreement are sophisticated, well represented, acting in good faith, and in furtherance of their own self-interest to maximize their respective recoveries. Moreover, parties to a post-petition lock-up should make sure to promptly disclose the agreement to the court.

Indianapolis Downs also offers an expansive interpretation of the propriety of a third-party release provision, especially where an impaired creditor has abstained from voting and taken no affirmative action consenting to the release. *Indianapolis Downs* should serve as a warning to creditors of the pitfalls of failing to review proposed plans and their accompanying ballots. All interested parties should make sure to carefully review any proposed plan and its release provisions to ensure awareness of the effect inaction may have on claims they may hold against non-debtor parties.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact Mark E. Felger at mfelger@cozen.com or 302.295.2087, or Keith L. Kleinman at kkleinman@cozen.com or 302.295.2077.

(Endnotes)

1. Case No. 11-11046 (BLS).
2. 11 U.S.C. § 1125(b) ("An acceptance or rejection of a plan may not be solicited after the commencement of the case . . . unless, at the time of or before such solicitation, there is transmitted . . . a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information").
3. *See In re Stations Holding Co.*, 2004 WL 1857116, at *1 (Bankr. D. Del. Aug. 18, 2004) (stating that the court had previously granted plan objector's motion to designate votes "finding the lock-up agreements were improper solicitations prohibited by Section 1125 of the Bankruptcy Code"); *see also In re NII Holdings, Inc.*, Case No. 02-11505 (Bankr. D. Del. 2002) (Order dated October 25, 2002); *see also Official Comm. of Unsecured Creditors of New World Pasta Co. v. New World Pasta Co.*, 322 B.R. 560, 568 (M.D. Pa. 2005) (restating the *Stations Holding* and *NII Holdings* rulings).
4. 11 U.S.C. § 1126(e) ("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*") (emphasis added).
5. *See Stations Holding*, 2004 WL 1857116, at *1; *see also In re NII Holdings*, Case No. 02-11505 (Bankr. D. Del. 2002) (Order dated October 25, 2002).
6. *In re Indianapolis Downs, LLC*, --- B.R. ----, 2013 WL 395137, at *3-*7 (Bankr. D. Del. Jan. 31, 2013).
7. The Chapter 11 bankruptcy cases of Indianapolis Downs and Indiana Downs are being jointly administered.
8. *Id.* at *2.
9. *Id.* at *3.
10. *Id.* at *5.
11. 376 B.R. 783, 794 (Bankr. N.D. Tex. 2007).
12. *Indianapolis Downs*, 2004 WL 1857116, at *6.
13. *Id.* at *5.
14. *Id.*
15. *Id.*
16. *Id.* at *6.
17. *Id.*
18. *Id.*
19. *Id.* at *7.
20. *Id.* at *16.
21. *Id.*
22. *Id.* at *17 (emphasis added).