Skadden

Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates

April 29, 2013

Post-Petition Restructuring Support Agreement Survives Challenge in Delaware

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Mark S. Chehi
Wilmington
302.651.3160
mark.chehi@skadden.com

Van C. Durrer II
Los Angeles
213.687.5200
van.durrer@skadden.com

* * *

Four Times Square, New York, NY 10036
Telephone: 212.735.3000

WWW.SKADDEN.COM

The U.S. Bankruptcy Court for the District of Delaware recently validated a post-petition restructuring support agreement (RSA). *In re Indianapolis Downs, LLC, et al.*, 486 B.R. 286 (Bankr. D. Del. 2013). Previous Delaware court decisions questioned the use and propriety of parties entering into RSAs after the commencement of a Chapter 11 case.[1]

The *Indianapolis Downs* decision provides a precedent and guidance for the successful use of post-petition Chapter 11 plan support agreements and for approval of reorganization plan terms that provide for creditor releases of nondebtor third parties.

Background

The debtors in *Indianapolis Downs* operated a combined horse racing track and casino in Indiana. They had substantial secured indebtedness: more than $98 million of first lien (first priority), $375 million of second lien and $78 million of third lien debt. The secured debt was held by sophisticated investors, and a group of second lien debt holders organized an ad hoc second lien committee to advance their objectives before the debtors' Chapter 11 cases commenced.

After struggling to meet their obligations, the debtors failed to make a mandatory interest payment to the second lien debt holders in late 2010. Despite efforts by the debtors, their equity owners, the ad hoc second lien committee and other constituencies to negotiate formal and informal restructuring proposals, prebankruptcy discussions did not produce a consensus. In April 2011, the debtors commenced their bankruptcy cases with the hope of ultimately consummating a comprehensive financial restructuring.

The RSA. After months spent in Chapter 11 litigation on various matters, the debtors and certain of their major constituencies, including the ad hoc second lien committee, were able to formulate an RSA, which outlined a "parallel-path" approach in which the debtors simultaneously would (i) test the market to determine whether an asset sale would generate sufficient funds to ensure creditor support; and (ii) explore a possible recapitalization to be implemented in the event of the market test's failure. In addition, the RSA included specific financial terms of creditor treatment under each of the parallel paths and set forth a timeframe for the debtors to propose the contemplated plan. Parties to the RSA were subject to certain restrictions, including (i) a prohibition against proposing, supporting or voting for a competing plan of reorganization; and (ii) a requirement that the parties vote in support of a plan complying with the RSA, though creditors retained the right to terminate the RSA for various reasons, including in the event of a material adverse change or a breach of certain representations by the debtors.

Filing and Objections. On April 25, 2012, the RSA was filed with the court immediately after it was executed. On the same date, the debtors filed the plan and a proposed disclosure statement that fully described the RSA. In June 2012, the court approved the disclosure statement. The debtors' sales effort ultimately resulted in a satisfactory of-

1 *See In re Stations Holding Co,. Inc.*, 2004 WL 1857116 (Bankr. D. Del. Aug. 18, 2004); *In re NII Holdings, Inc.*, 288 B.R. 356 (Bankr. D. Del. 2002).

fer for the purchase of substantially all of the debtors' assets and, in October 2012, the court conducted a combined hearing on approval of the sale and confirmation of the plan (which was predicated on the sale).

Certain equity holders, senior management and creditors objected to the plan's confirmation. They argued that negotiation and execution of the RSA constituted a wrongful post-petition "solicitation" of votes on the plan prior to court approval of the disclosure statement, violating Sections 1125(g) and 1126(e) of the U.S. Bankruptcy Code.[2] They contended that the RSA was an impermissible solicitation and, as such, creditor votes cast in favor of the plan by parties to the RSA should be "designated" (*i.e.*, disregarded and not counted), which would result in the plan lacking sufficient votes. The debtors and other parties to the RSA disagreed, contending that the development and execution of the RSA was not a wrongful solicitation of plan votes before approval of the disclosure statement.

The plan objectors also argued that certain third-party release terms of the plan were impermissible.

The Court's Decision

Use of Post-Petition RSA. At the confirmation hearing, the plan objectors contended that the votes cast by the parties to the RSA were invalid because their decision to vote to accept the plan was pursuant to the RSA, and therefore impermissibly solicited without a court-approved disclosure statement.

Judge Brendan L. Shannon disagreed. In denying the objectors' motion, the court observed that "the filing of a Chapter 11 petition is an invitation to negotiate." *Indianapolis Downs* at 297. "When a deal is negotiated in good faith between a debtor and sophisticated parties, and that arrangement is memorialized in a written commitment and promptly disclosed, [the solicitation requirements of Section 1126 of the Bankruptcy Code] … will not automatically require designation of the votes of the participants." *Id.*

Judge Shannon reviewed binding precedent in the U.S. Court of Appeals for the Third Circuit, including *In re Century Glove*, 860 F.2d 94 (3d Cir. 1988), which recognized the importance of negotiations to the success of a Chapter 11 reorganization and, based on this precedent, construed formal "solicitation" narrowly. He distinguished earlier Delaware bankruptcy decisions questioning the propriety of RSAs in the context of prepackages solicitations. *Indianapolis Downs* at 295. Judge Shannon acknowledged the importance of dealmaking in the Chapter 11 context as well as the "critical" nature of a creditor's ability to vote on a proposed restructuring. As a result, the *Indianapolis Downs* ruling validates the use of a post-petition RSA as an important tool to forge consensus on a Chapter 11 reorganization plan.

Fee and Expense Reimbursements. The decision also ruled against the assertion that RSA-required reimbursement of legal fees and expenses of RSA parties allowed these parties to receive better treatment on their claims than those afforded to other creditors. Judge Shannon approved the reimbursements, agreeing with the debtors that such reimbursements were separate and distinct from payment on the creditors' claims (so there was no disparate treatment of similar claims under the plan), and by finding that such reimbursement was a necessary administrative expense that preserved the bankruptcy estate. *Id.* at 301 (citing 11 U.S.C. § 503(b)(1)(A)).

Third-Party Releases. The *Indianapolis Downs* plan objectors challenged proposed third-party release terms of the debtors' plan. Specifically, the plan provided that certain nondebtors would be

---

2 Section 1125(b) of the Bankruptcy Code provides that acceptance or rejection of a plan may not be solicited post-petition unless a written disclosure statement approved by the bankruptcy court as containing "adequate information" is transmitted at the time of the solicitation. 11 U.S.C. §1125(b). "Adequate information" is defined in Section 1125(a) as information that would enable a hypothetical investor to make an informed judgment regarding a plan of reorganization. 11 U.S.C. §1125(a).

released (or deemed released) from possible claims against them that might be held or asserted by certain categories of creditors. This includes creditors that (i) voted on the plan but did not "opt out" of the release, (ii) were not impaired by the plan and (iii) did not vote on the plan but did not "opt out" of the releases (by, for instance, failing to return a ballot at all). The plan objectors, including the Office of the United States Trustee, argued that such third-party releases were permissible only if creditors had consented or creditors in the latter two categories had taken insufficient steps to evidence such consent.

The court overruled the objections to the third-party release terms of the plan by following the ruling in *In re Spansion*, 426 B.R. 114 (Bankr. D. Del. 2010) that "returning a ballot is not essential to demonstrating consent to a release." Judge Shannon indicated a "more flexible approach" was warranted. *Indianapolis Downs* at 305. He emphasized that unimpaired creditors had received consideration for the releases and that creditors who elected not to vote at all had received "detailed instructions" on the opt-out procedure and had elected not to pursue it. *Id.* at 306. In doing so, he decided that the plan's third-party release terms were supported by creditor consents.

Implications

The *Indianapolis Downs* decision articulates clearer standards of approval for entering into an RSA after the commencement of a Chapter 11 case as well as providing for creditor releases of nondebtor third parties through plan terms.

Notably, the *Indianapolis Downs* RSA differed from those at issue in the earlier Delaware bankruptcy court decisions (*Stations Holding* and *NII Holdings*) that questioned the propriety of RSAs. In those cases, the agreements did not provide creditors who signed a post-petition RSA with the opportunity to vote against the contemplated plan, even if the disclosure statement ultimately approved by the court contained materially different information than what the creditors had available at the time they executed the RSA.

In contrast, the *Indianapolis Downs* RSA contained detailed default provisions permitting creditors to terminate that RSA if the debtors' representations to signatory creditors proved false or events changed materially. It follows that the presence (or absence) of such creditor-friendly RSA provisions may be important to judicial scrutiny and approval (or not) of post-petition RSAs and similar Chapter 11 lock-up agreements.