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Delaware Bankruptcy Court Declines to Designate Votes of Parties to a Post-Petition Restructuring Support Agreement

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In In re Indianapolis Downs, LLC*, the Bankruptcy Court for the District of Delaware provided direction on what constitutes an acceptable "post-petition lock-up agreement" and joined a majority of decisions that have narrowly construed the prohibition in the Bankruptcy Code against post-petition solicitation of a vote for a plan prior to circulation of a court-approved disclosure statement. This article discusses the case.*

The Bankruptcy Court for the District of Delaware in *In re Indianapolis Downs, LLC*[1] declined to designate the votes of parties to a post-petition restructuring support agreement (i.e., a lock-up agreement), instead confirming the debtors' Modified Second Amended Joint Plan of Reorganization (the "Plan") based on the votes of such parties. In doing so, the court provided direction on what constitutes an acceptable "post-petition lock-up agreement" and joined a majority of decisions that have narrowly construed the prohibition in the Bankruptcy Code against post-petition solicitation of a vote for a plan prior to circulation of a court-approved disclosure statement.

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FACTUAL BACKGROUND

The debtors, Indianapolis Downs, LLC and Indiana Capital Corp., operated a horse racing track and casino—a "racino"—in Shelbyville, Indiana, where patrons could engage in a wide variety of wagering activities. Prior to bankruptcy, debtors had substantial indebtedness, and in late 2010, debtors failed to make the requisite interest payments due to holders of the second lien debt. After pre-bankruptcy negotiations did not resolve the issues, debtors filed for protection under Chapter 11 of the Bankruptcy Code.

After months of negotiations and intermittent litigation, a group of holders of the second lien debt (the "Ad Hoc Second Lien Committee"), and Fortress Investment Group, LLC ("Fortress") (who held a substantial portion of the third lien debt, as well as second lien debt) ultimately agreed to a "parallel path" approach to reorganization with the debtors. Under the "parallel path" approach, which was memorialized in a "post-petition lock-up agreement" called the Restructuring Support Agreement (the "RSA"), the parties agreed that the debtors would test the markets to determine if a satisfactory sales price could be obtained, but if not, the debtors would proceed with recapitalization. Among other things, the RSA included a provision prohibiting "any party to the RSA [from] proposing, supporting or voting for a competing plan of reorganization," and required "that parties to the RSA vote 'yes' for a plan that complies with the RSA." The RSA also contained a clause for specific performance and injunctive or other equitable relief if the RSA was breached. The RSA was binding upon execution on creditor signatories (Fortress and the members of the Ad Hoc Second Lien Committee), and upon the debtors once the court approved the disclosure statement.

The debtors subsequently received a satisfactory bid from Centaur LLC ("Centaur"), and requested court approval of the sale to Centaur and confirmation of the Plan upon which the sale was predicated. Certain members of senior management and holders of equity and debt of the debtors (collectively, the "Oliver Parties") objected to confirmation of the Plan, arguing that the RSA constituted an impermissible solicitation of votes post-petition, in contravention of § 1125(b) of the Bankruptcy Code. The Oliver Parties further maintained that the votes of the parties to the RSA should be designated pursuant to § 1126(e), which would ultimately result in rendering the debtors incapable of securing sufficient votes to confirm the plan.

BANKRUPTCY CODE §§ 1125 AND 1126

Section 1125(b) of the Bankruptcy Code provides the structured format by which a Plan proponent must seek approval for its Plan:

> (b) An acceptance or rejection of a plan may not be solicited after the commencement of the case under this title from a holder of a claim or interest with respect to such claim or interest, unless, at the time of or before such solicitation, there is transmitted to such holder 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.[2]

Under § 1126(e), the court may, at the request of a party in interest, and after notice and a hearing, designate the votes of any party 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 Chapter 11 of the Bankruptcy Code.[3]

THE COURT'S ANALYSIS OF §§ 1125 AND 1126

The court found that the RSA did not constitute an improper solicitation of votes and refused to designate the votes of the parties to the RSA. In reaching that conclusion, the court reasoned that since Congress intended for creditors and debtors to negotiate with 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." The court further found that the original intent of § 1125(b) was to protect the interest of "creditors and stockholders [who] were too illinformed [sic] to act capably in their own interests," but that here, the parties, "sophisticated financial players…represented by able and experienced professionals," were not in need of such oversight. Finally, the court underscored the importance of creditor suffrage, noting that "[d]esignation of a creditor's vote is a drastic remedy, and, as a result, designation of votes is the exception, not the rule."[4]

In reaching its conclusion, the court relied upon the Third Circuit deci-

sion in *In re Century Glove*.[5] In that case, the Third Circuit was confronted with deciding the propriety of the creditors' activity, when one creditor circulated a competing "draft" plan that was not approved by the court, in an attempt to convince other creditors to reject the debtor's plan. The court in *Century Glove* ultimately refused to find that the creditor's actions constituted solicitation, explaining that "[w]e find no principled, predictable difference between negotiation and solicitation of future acceptances. We therefore reject any definition of solicitation which might cause creditors to limit their negotiations."

The court in *Indianapolis Downs* also borrowed from the reasoning of *In re Heritage Organization, LLC.*[6] In that case, the Chapter 11 Trustee and some of the former Heritage clients with claims in the case (the "Client Claimants") signed a Term Sheet that provided, among other things, that the Claimants would vote to accept the plan. The Trustee and the Client Claimants then filed a disclosure statement and a joint plan, and the court refused to designate the votes of the Claimants, concluding that "if a creditor believes that it has sufficient information about the case and the available alternatives to jointly propose a Chapter 11 plan with another entity… it is absurd to think that the signing of a term sheet by those parties…is an improper solicitation of votes in accordance with § 1125(b)." The court in *Indianapolis Downs* found the situation it was confronted with analogous, stating that "[w]hile the Restructuring Support Parties are not coproponents [sic] of the Debtors' Plan, given their significant respective stakes in the Debtors and the Court's own observation of these parties' involvement in these proceedings, precisely the same considerations pertain here…."

THE BIGGER PICTURE

In reaching the conclusion in *Indianapolis Downs*, the court distinguished the case from the outcomes in two other Delaware bankruptcy cases, *In re Stations Holdings Co., Inc*,[7] and *In re NII Holdings, Inc.*[8] In those cases, the court designated the vote of the creditors who had participated in post-petition lock-up agreements. The court in *Indianapolis Downs* found that those pre-packaged cases had "markedly different factual and procedural context[s]" and, as the decisions were two-page orders with no legal

analysis, were of "limited (if any) precedential value." The court found that the interests of disclosure underlying § 1125 were not at material risk where the voters in question were sophisticated financial players represented by able and experienced professionals, noting that the argument that the voters should have been afforded a chance to review a court-approved disclosure statement, even after signing the RSA, would "grossly elevate form over substance."

Notably, the court in *Heritage* had distinguished the Client Claimants' lock-up agreement from those in *Stations Holdings* and in *NII Holdings* in part because the Client Claimants' lock-up agreement did not contain a provision requiring specific performance. The court in *Heritage* stated that part of the reason the courts in *Stations Holdings* and in *NII Holdings* designated the votes of the parties to the lock-up agreements was that specific performance provisions prevented the "locked-up creditor [from] 'reconsider[ing] its preliminary decision' to vote in favor of the plan after receiving adequate information, and the locked-up creditor was stripped of the Bankruptcy Code's protection against the harm caused by solicitation without court-approved, adequate information." Interestingly, in refusing to designate the votes, the court in *Indianapolis Downs* noted that "if the Plan as filed conformed to the heavily-negotiated RSA, the parties were entitled to demand and rely upon assurances that accepting votes would be cast by the parties thereto."

It remains to be seen whether *Indianapolis Downs* is herald to a new line of cases where bankruptcy courts will be called upon to determine the legitimacy of various post-petition lock-up agreements memorializing complex negotiations among sophisticated parties, or certain provisions thereof, when plan solicitation, voting and confirmation are challenged.

NOTES

[1] No. 11-11046 (BLS), 2013 WL 395137 (Bankr. D. Del. Jan. 31, 2013).
[2] 11 U.S.C. § 1125(b).
[3] 11 U.S.C. § 1126(e).
[4] *In re Adelphia Commc'ns. Corp.*, 359 B.R. 54, 61 (Bankr. S.D.N.Y. 2006).
[5] 860 F.2d 94 (3d. Cir. 1988).
[6] 376 B.R. 783 (Bankr. N.D. Tex. 2007).

[7] No. 02-10883 (MFW) (Bankr. D. Del. 2002) (Order dated September 30, 2002) [Docket No. 177].

[8] No. 02-11505 (MFW) (Bankr. D. Del. 2002) (Order dated October 25, 2002) [Docket No. 367].