CHAPTER 3. THE BANKRUPTCY CODE APPLIED TO PREPACKS (AND THE EFFECT OF BAPCPA)

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) made two key changes to the Bankruptcy Code affecting prepackaged bankruptcies. New § 1125(g) now explicitly allows the solicitation of votes on a plan of reorganization to be conducted before the petition date and may also allow the receipt of such votes after the petition date. Additionally, new § 341(e) now allows a party in interest to request that the U.S. Trustee refrain from convening a meeting of creditors if acceptances have been solicited for a prepackaged bankruptcy plan and may effectively allow the avoidance of the appointment of a creditors' committee, which would otherwise be required by § 1102(a)(1) of the Bankruptcy Code.

I. New § 1125(g) of the Bankruptcy Code[41]

Prior to the enactment of BAPCPA, without proper postpetition disclosure, postpetition voting on a plan proposed prepetition would invalidate such votes. Section 1125(b) of the Bankruptcy Code prevents postpetition solicitation of acceptance or rejection of a plan prior to court approval, after notice and a hearing, of a disclosure statement. While § 1126(b) allows counting of votes cast prior to the commencement of a case, § 1125(b) had been held to require receipt before filing of all votes.

A 1997 report from the National Bankruptcy Review Commission (the "1997 Commission") recognized this problem, and the 1997 Commission recommended that § 1125 of the Bankruptcy Code be amended to allow prepack solicitation to be completed postpetition:

> Literally interpreted, [§ 1125(b)] precludes the post-petition continuation or completion of the solicitation process begun prepetition in a prepack… [Consequently, a] debtor who has not yet completed every aspect of a prepack solicitation at the moment of filing a petition must forfeit many

41 In relevant part, § 1125(g) of the Bankruptcy Code provides: "an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable nonbankruptcy law." 11 U.S.C. § 1125(g).

> of the advantages of a prepack by returning to the much slower Chapter 11 track when the process may be almost complete.[42]

The 1997 Commission's concerns manifested in a pair of Delaware bench rulings' *In re Stations Holding Co.* and *In re NII Holdings Inc.*[43]' both issued in 2002 by Judge Mary Walrath. In these rulings, certain votes received postpetition on plan support agreements were invalidated by the court after objections from the U.S. Trustee.

In the more instructive of these 2002 decisions, *NII Holdings*, confirmation of a plan with broad support that had been negotiated prepetition failed because some of the plan support agreements were executed a few days after filing. Prior to filing, the debtor had negotiated plan support agreements with creditors holding 96 percent in amount and 83 percent in number of its bonds. While not containing a plan or votes for a plan, those agreements obligated the executing creditors to "vote all of [their] claims against [the debtor] in favor of the Plan and not to revoke or withdraw such vote," and to not support any competing plan of reorganization.[44] Because the debtor wanted to avoid a market reaction to its filing, the debtor filed on a Friday evening before some of the agreements were executed; they were subsequently executed five days after filing.[45] Despite no objections from economic stakeholders,[46] the U.S. Trustee moved to exclude votes from the late-signed agreements. The U.S. Trustee argued that because the plan support agreements affirmatively obligated the parties to cast accepting ballots (enforceable through specific performance), it was essentially an official ballot.[47] Then, because it was executed after the petition date, it violated § 1125(b) of the Bankruptcy Code, since "these [votes] were obtained before the

42 Nat'l Bankr. Rev. Comm'n, 1 Report of the *National Bankruptcy Review Commission* ¶ 2.14.18 (1997) [hereinafter, "1997 Report"].

43 *In re NII Holdings Inc.*, Case No. 02-11505-MFW (Bankr. D. Del. 2002), and *In re Stations Holding Co.*, Case No. 02-10882-MFW (Bankr. D. Del. 2002).

44 *See* Motion of the Acting United States Trustee Pursuant to 11 U.S.C. §§ 1125(b), 1126(b), 1126(d) and 1126(e) for an Order (1) Designating Persons Who Executed Lock-Up Agreements, (2) Directing That The Ballots Cast by Such Persons not be Counted, (3) Imposing Sanctions, and/or Granting Other Relief, *In re NII Holdings Inc.*, Case No. 02-11505-MFW (Bankr. D. Del. Sept. 30, 2002) [Docket No. 290].

45 *See* Transcript of Oct. 22, 2002 Hearing at 49, *In re NII Holdings Inc.*, Case No. 02-11505-MFW (Bankr. D. Del. Oct. 22, 2002) [hereinafter, "*NII Holdings Transcript* Oct. 22, 2002"] (counsel for bondholders argued that "[t]here's been no wrongdoing here, Your Honor. There's been the intervention of a holiday weekend at the very tail end of what was a very difficult and hard-fought process. And a decision by a debtor that it, as a business matter, wanted to have a long holiday weekend in Latin America to approach people and deal with vendor issues and other matters critical to the business...").

46 *See NII Holdings Transcript* Oct. 22, 2002, fn. 45, at 37 (counsel for bondholders: "And I can tell you... that if the bondholders didn't want to vote for this—yes for this plan, they wouldn't have voted because they thought they could be compelled to under the support agreement").

47 *See NII Holdings Transcript* Oct. 22, 2002, fn. 45, at 13.

approval of the disclosure statement."[48] The debtors argued that the basic terms of the agreement had been memorialized in a term sheet dated prepetition and that the plan support agreements required only "ministerial edits." The debtors further argued that § 1125(b) did not provide a bright-line rule and finally that there was no postpetition solicitation because the debtors did not request or seek acceptance of a plan.[49] The court granted the U.S. Trustee's motion and designated the votes because finding "a [plan support] agreement in this form is not a solicitation of a vote [and] would mean eviscerating that from the bankruptcy code completely… [A]lthough it has conditions to actually signing the ballot, those conditions...are not significant."[50]

Hence, § 1125(b)'s bright-line rule made prepackaged bankruptcies susceptible to technical mishandling and mischief. As such, as the 1997 Commission observed, an activist or otherwise litigious creditor could use § 1125(b)'s rule against a prospective debtor in the negotiation of a prepack:

> [T]he debtor in the midst of negotiating a prepack is vulnerable to having the process derailed by any creditor who decides to file an involuntary petition. The threat to make such a filing gives a sophisticated creditor a bargaining advantage based on nothing more than the ability to terminate the debtor's prepack negotiations.[51]

Because the automatic stay does not apply before a filing, a prospective debtor cannot prevent creditors from initiating an involuntary proceeding or exercising remedies before it files its prepack. Thus, hold-out creditors would have leverage to demand a better deal, and prospective debtors would be at risk of creditors taking action before the filing. Such a threat might stymie any prepackaged plan or forestall negotiation, adversely affecting the estate.

The new § 1125(g) of the Bankruptcy Code expressly authorizes that which § 1125(b) does not prohibit—prepetition solicitation of a plan—and arguably provides a safe harbor from § 1125(b)'s bright-line rule:

48 *See NII Holdings Transcript* Oct. 22, 2002, fn. 45, at 60.

49 *See* Objection of Debtors and Debtors in Possession to Motion of the Acting United States Trustee Pursuant to 11 U.S.C. §§ 1125(b), 1226(b), 1226(d) and 1126(e) For an Order (1) Designating Persons Who Executed Lock-Up Agreements, (2) Directing That the Ballots Cast by Such Persons not be Counted, (3) Imposing Sanctions, and/or (4) Granting Other Relief, *In re NII Holdings, Inc.*, Case No. 02-11505-MFW (Bankr. D. Del. Oct. 17, 2002) [Docket No. 312].

50 *See NII Holdings Transcript Oct.* 22, 2002, fn. 45, at 60 (judge noting that "if this is not soliciting a vote in favor of the debtor's plan, I don't know what is").

51 1997 *Report*, fn. 42, at ¶ 2.4.18.

> Notwithstanding subsection (b), an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable nonbankruptcy law.[52]

The post-BAPCPA rule allows a prospective debtor to solicit votes for its plan before filing and—assuming that "solicitation" is judicially interpreted to mean the mere transmission by the debtor-to-be to its creditors of (1) a solicitation package for a plan, (2) a disclosure statement and (3) a plan ballot, rather than the actual completion of voting—arguably allows the debtor to accept those votes even after filing.[53]

This new provision may prevent hold-out creditors from derailing the prepackaged process.[54] Rather than being subject to such hold-outs, a prospective debtor could commence solicitation on its proposed plan of reorganization and soon thereafter file its petition to prevent potentially litigious hold-out creditors from taking preemptive action. In such a case, the voting period would "straddle" the petition date. The SDNY Prepack Guidelines suggest that this sort of a "straddle" may be permissible.[55] However, bankruptcy professionals have noted that "the guidelines expressly reserve the court's power to determine the treatment of votes received postpetition, whereas votes received prepetition are automatically treated like other plan votes."[56] The "straddle" strategy could be beneficial for a debtor caught between the need for a protective filing to forestall creditor remedies and the benefits of a prepack (*see* Chapter 6.III for more on this strategy). Commentators have raised several unanswered questions about a "straddle" strategy: "What are the implications of postpetition plan supplements on the validity of votes solicited prepetition? Would a court view a straddle more favorably if the debtor were to delay its filing...until

52 11 U.S.C. § 1125(g); *see*, *e.g.*, Confirmation Order, *In re American Media Inc.*, Case No. 10-16140-MG, 2010 WL 5483463, at 6 (Bankr. S.D.N.Y. Dec. 20, 2010) (explicitly noting that prepack vote solicitation and vote tabulation were conducted in compliance with § 1125(g)); Confirmation Order, *In re Haights Cross Communications Inc.*, Case No. 10-10062-BLS, 2010 WL 2723979 at 8 (Bankr. D. Del. Feb. 24, 2010) (same).

53 *See*, *e.g.*, Kurt A. Mayr, "Unlocking the Lockup: The Revival of Plan Support Agreements Under New § 1125(g) of the Bankruptcy Code," 15 *Norton Journal of Bankruptcy Law and Practice* 729, 732 (Dec. 2006) ("This safe harbor would have protected the postpetition activity that occurred in *NII Holdings*, even assuming such activity was a 'solicitation.'").

54 *See* Alan N. Resnick & Henry J. Sommer, 4 *Collier on Bankruptcy* § 14[1] (16th Ed. 2010) [hereinafter, "Collier on Bankruptcy"]; 1997 Report, fn. 42.

55 *See* SDNY Prepack Guidelines § III.C ("[A]fter the Debtor has transmitted all solicitation materials to holders of claims and interests whose vote is sought but before the deadline for casting acceptances or rejections of the Debtor's plan (the 'Voting Deadline')...the Debtor and other parties in interest shall be permitted to accept but not solicit ballots until the Voting Deadline.").

56 James M. Millerman, Steven C. Krause & Arvin I. Abraham, "A Novel Approach to Vote Solicitation on Prepackaged Plans," *Daily Bankruptcy Review*, Oct. 6, 2010, at 12.

receipt by creditors could be confirmed?"[57] Despite the current state of uncertainty on several important issues, the addition of § 1125(g) to the Bankruptcy Code represents an acknowledgment by Congress of the benefits of prepacks for both debtors and creditors who want to restructure businesses in an efficient manner.

II. New § 341(e) of the Bankruptcy Code[58]

Section 341(e) of the Bankruptcy Code may allow a prepackaged bankruptcy case to be conducted without the appointment of a creditors' committee. It is helpful to evaluate the implications of § 341(e) within the context of other applicable sections of the Bankruptcy Code. Section 1102(a)(1) of the Bankruptcy Code provides that the U.S. Trustee "shall appoint a committee of creditors."[59] Additionally, § 341(a) of the Bankruptcy Code provides that the U.S. Trustee shall convene a meeting of creditors "within a reasonable time after the order for relief."[60] In a chapter 11 case, the creation of a creditors' committee typically occurs at the § 341(a) meeting, which the U.S. Trustee convenes in order to examine the debtor and be heard generally "in an advisory capacity on questions concerning the administration of the estate.[61]

The purpose of the addition of § 341(e) to the Bankruptcy Code is to give the court the flexibility "to eliminate the requirements of § 341 when the plan process is so far along that a meeting of creditors will be a waste of time."[62] As a practical matter, § 341(e) is often used by debtors and courts to delay the § 341(a) meeting of creditors until several months after the petition date, such that the meeting will occur only if the prepackaged plan has

57 James M. Millerman, Steven C. Krause & Arvin I. Abraham, "A Novel Approach to Vote Solicitation on Prepackaged Plans," *Daily Bankruptcy Review*, Oct. 6, 2010, at 12.

58 In relevant part, § 341(e) of the Bankruptcy Code provides that "the court, on the request of a party in interest and after notice and a hearing, for cause may order that the United States trustee not convene a meeting of creditors or equity security holders if the debtor has filed a plan as to which the debtor solicited acceptances prior to the commencement of the case." 11 U.S.C. § 341(e).

59 11 U.S.C. § 1102(a)(1).

60 11 U.S.C. § 341(a).

61 *See* 3 *Collier on Bankruptcy* ¶ 341.01.

62 2 Norton Bankr. L. & Prac. 3d § 33:6. In relevant part, § 341(e) of the Bankruptcy Code provides: "The court, on the request of a party in interest and after notice and a hearing, for cause may order that the [U.S. Trustee] not convene a meeting of creditors or equity security holders if the debtor has filed a plan as to which the debtor solicited acceptances prior to the commencement of the case." 11 U.S.C. § 341(e).

not been confirmed by that time.[63] As others have noted previously, "[p]resumably, this provision is intended to expedite prepackaged chapter 11 cases in which there exist from the outset sufficient votes to confirm the plan."[64] As is discussed below, the SDNY Prepack Guidelines and other jurisdictions' guidelines reinforce this result for prepacks that leave general unsecured creditors unimpaired.[65]

Since § 341(e) was added to the Bankruptcy Code in 2005, there have been a number of prepackaged chapter 11 cases in which bankruptcy courts have directed the U.S. Trustee *not* to convene a meeting of creditors. For example, in *Xerium*, the debtors submitted a prepackaged plan of reorganization that was confirmed by the judge who also denied a motion to reconsider an order directing the U.S. Trustee not to convene a meeting of creditors.[66] The debtors' motion sought a court order directing the U.S. Trustee not to convene a meeting of creditors, citing § 341(e) of the Bankruptcy Code and also arguing that the parties in interest were not likely to receive a benefit from a creditors' meeting because the agreed-upon prepack provided "full recoveries to all general unsecured creditors, a distribution to equity-holders, and an expeditious emergence from chapter 11."[67] The debtors further supported their successful argument by reference to a number of recent decisions in which the U.S. Bankruptcy Court for the District of Delaware granted

63 *See, e.g.*, Order (I) Scheduling a Combined Hearing to Consider (A) Approval of the Disclosure Statement, (B) Approval of the Solicitation Procedures and Forms of Ballots and (C) Confirmation of the Prepackaged Plan; (II) Establishing Deadlines and Procedures to File Objections to the Disclosure Statement, the Solicitation Procedures and the Prepackaged Plan; (III) Approving the Form and Manner of Notice of the Confirmation Hearing and (IV) Granting Related Relief, *In re Affiliated Media Inc.*, Case No. 10-10202-KJC, (Bankr. D. Del. 2009) (stating that "[t]he meeting pursuant to section 341(a) of the Bankruptcy Code shall not be convened, pursuant to section 341(e) of the Bankruptcy Code, unless the Prepackaged Plan is not confirmed by this Court within ninety (90) days after the Petition Date.").

64 *See* 3 *Collier on Bankruptcy* ¶ 341.05A.

65 *See* SDNY Prepack Guidelines § VIII.C.

66 *In re Xerium Technologies Inc.*, 2010 WL 3313079 (Bankr. D. Del. May 12, 2010).

67 *See* Motion of Debtors for Entry of Orders Pursuant to 11 U.S.C. 105(a), 341(e) and 521(a); Fed. R. Bankr. P. 1007, 2015.3 and 9006(b); and Del. Bankr. L.R. 1007-1(b) and 1007-2(a) (I) Authorizing the Debtors to File a Modified Creditor Matrix and Modified Equity Security Holders List, (II) Approving the Manner of Notices to the Debtors' European Employees, (III) Extending Time Within Which to File (a) Schedules and Statements and (B) Financial Reports Pursuant to Fed. R. Bankr. P. 2015.3(a), (IV) Waiving the Requirement to File Schedules, Statements, and Financial Reports Upon the Effective Date of the Debtors' Prepackaged Plan, and (V) Directing the United States Trustee not to Convene a Meeting of Creditors or Equity Security Holders or Appoint a Statutory Committee at ¶ 34, *In re Xerium Technologies Inc.*, 2010 WL 2213287 (Bankr. D. Del. March 30, 2010) [hereinafter, "*Xerium Motion of Debtors*"].

relief to similarly situated debtors.[68] A number of recent decisions illustrate the proposition that bankruptcy courts will not hesitate to utilize § 341(e) of the Bankruptcy Code to disallow statutory meetings of creditors' committees in prepack cases.

At least one court has found that a creditors' committee may be unnecessary in a prepack even if not all general unsecured creditors are unimpaired.[69] In *NTK*, a group of creditors holding general unsecured claims, which would be impaired under the plan, objected to such a cramdown and filed a motion to compel appointment of a creditors' committee.[70] This motion argued that (1) § 1102(a) of the Bankruptcy Code requires appointment of a creditors' committee "as soon as practicable," (2) the bankruptcy court should review the decision under a *de novo* standard citing a decision from the U.S. Bankruptcy Court of the Southern District of New York, and (3) unsecured creditors with claims against the parent company were "not reserved a seat at the bargaining table."[71] An ad hoc creditor group supporting the prepack objected to the motion, arguing that the court should (1) apply an abuse of discretion standard to the U.S. Trustee's decision not to appoint a committee, citing decisions from bankruptcy courts in Delaware, and (2) deny the motion under either an abuse-of-discretion standard or a *de novo* standard. This objecting ad hoc creditor group further argued that the movant did not need such a committee as the movant was itself "very capable of advocating its position."[72] They advocated that the court also find that the appointment of the committee of a few creditors with parochial interests where other creditors had no interest in serving on a committee (because they were unimpaired) did not satisfy the standard of "necessary to ensure adequate representation of creditors"

68 *See Xerium Motion of Debtors,* fn. 67, at ¶ 35 (citing *In re Lazy Days' R.V. Center Inc.*, Case No. 09-13911-KG (Bankr. D. Del. Dec. 8, 2009); *In re Portola Packaging. Inc.*, Case No. 08-12001-CSS (Bankr. D. Del. Sept. 22, 2008); *In re Mrs. Fields' Original Cookies Inc.*, Case No. 08-11953-PJW (Bankr. D. Del. Aug, 26, 2008); *In re Holley Performance Prods. Inc.*, Case No. 08-10256-PJW (Bankr. D. Del. Feb 14, 2008); *In re Remy Worldwide Holdings Inc.*, Case No. 07-11481-KJC (Bankr. D. Del. Oct. 10, 2007)).

69 *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. 2009).

70 Motion of Ore Hill Partners LLC To Compel the United States Trustee To Appoint an Official Committee of Unsecured Creditors as Required by Section 1102(A), *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Nov. 23, 2009) [Docket No. 144].

71 Motion of Ore Hill Partners LLC To Compel the United States Trustee To Appoint an Official Committee of Unsecured Creditors as Required by Section 1102(A), *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Nov. 23, 2009) [Docket No. 144].

72 Ad Hoc Committee's Objection To Motion of Ore Hill Partners LLC To Compel the United States Trustee To Appoint an Official Committee of Unsecured Creditors as Required by Section 1102(A) at 7, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 1, 2009) [Docket No. 164].

under § 1102(a)(4) of the Bankruptcy Code.[73] The court agreed with the ad hoc committee and denied the unsecured creditors' motion to appoint a creditors' committee.[74]

The ad hoc committee argued that the U.S. Trustee was entitled to use discretion whether or not to appoint a creditors' committee based on the "shall appoint a committee" language of § 1102 of the Bankruptcy Code.[75] They argued that otherwise, application of § 1102 could produce an absurd result, such as a creditors' committee with only unappealing or unsavory members, for example if "the only creditor [to] show up [at] the formation meeting was Bernie Madoff."[76] The ad hoc committee further asserted that a creditors' committee needs to fairly represent the majority of creditors and noted that there were 556 creditors who voted "yes" and only 32 who voted "no" to the prepackaged plan.[77]

During the hearing, the court noted that the motion was essentially a request to create a creditors' committee solely representing creditors of the parent company, NTK Holdings, under § 1102(a)(2) of the Bankruptcy Code because it would not include representatives from creditors of its various subsidiaries.[78] However, because the request was made solely under § 1102(a)(1) of the Bankruptcy Code, the court only considered the motion under that section and did not reach the § 1102(a)(2) analysis.[79] The court then found that (1) an abuse-of-discretion standard was proper, (2) nothing in the record "warrant[ed] an upsetting of the deference that Courts...give to the U.S. Trustee in committee selection" and (3) the movant was currently allowed to pursue its legal rights and interests and could later receive an award in a contribution action rather than having the debtors' estate pay for its legal expenses immediately through formation of a creditors' committee.[80] The ruling

73 Ad Hoc Committee's Objection To Motion of Ore Hill Partners LLC To Compel the United States Trustee To Appoint an Official Committee of Unsecured Creditors as Required by Section 1102(A) at 7, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 1, 2009) [Docket No. 164].

74 Order Denying Motion of Ore Hill Partners LLC, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 9, 2009) [Docket No. 232].

75 Transcript of Hearing at 68-9, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 4, 2009).

76 Transcript of Hearing at 69, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 4, 2009).

77 Transcript of Hearing at 70, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 4, 2009).

78 Transcript of Hearing at 74, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 4, 2009).

79 Transcript of Hearing at 74, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 4, 2009).

80 Transcript of Hearing at 74-75, *In re NTK Holdings Inc.*, Case No. 09-13611-KJC (Bankr. D. Del. Dec. 4, 2009).

in *NTK* demonstrates that bankruptcy courts may be deferential to the U.S. Trustee if it decides not to appoint an official creditors' committee in a prepack even when faced with (minority) unsecured creditors who are subject to binding cramdown provisions.