

10-1-2018

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Recommended Citation

Edward J. Janger & Adam J. Levitin, *Badges of Opportunism: Principles for Policing Restructuring Support Agreements*, 13 Brook. J. Corp. Fin. & Com. L. (2018).

Available at: <https://brooklynworks.brooklaw.edu/bjcfcl/vol13/iss1/8>

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BADGES OF OPPORTUNISM: PRINCIPLES FOR POLICING RESTRUCTURING SUPPORT AGREEMENTS

*Edward J. Janger** & *Adam J. Levitin***

ABSTRACT

Bankruptcy is a market for corporate control. Current bankruptcy practice offers two alternative mechanisms for effectuating changes in control of a firm: (1) a pre-plan all-asset sale under section 363(b) of the Bankruptcy Code; or (2) an asset sale or recapitalization pursuant to a plan of reorganization under section 1129 of the Code. Pre-plan sales under section 363(b) are fast, but lack the procedural protections associated with a restructuring or sale pursuant to a plan. Plan confirmation can be costly and uncertain, however. Restructuring support agreements (“RSAs”)—contractual agreements to support a future restructuring that has certain agreed-upon characteristics—appear to offer a salutary bridge between the efficiencies of a quick sale and the procedural protections of a plan. RSAs, however, can also facilitate opportunistic behavior that enable creditors to hold value maximization hostage to an adjustment in distributional priority.

This Article explores the use of RSAs in corporate control transactions in bankruptcy. We catalogue the good and bad uses of RSAs. We show how RSAs can be used to effectuate an “end-run” around the plan process and identify certain “badges of opportunism” that should serve as red flags for abusive RSAs. From this we articulate a central norm of Chapter 11, namely that the common interest in value maximization may not be held hostage by individual creditors seeking to improve their priority. This underlying principle provides a general metric for how to distinguish coordination from opportunism in RSAs.

INTRODUCTION

Business reorganizations are, by definition, a form of corporate control transaction. When a debtor is insolvent, control is in play along two different axes. The first axis allocates control within the existing capital structure. The filing of bankruptcy effectuates a change of control from equity to debt.¹

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1. On the one hand this is an implication of the “absolute priority rule” of 11 U.S.C. § 1129(b)(2)(B) (2018). It is also a practical effect of the shifting of supervision from the board of

Second, the company itself is on the auction block, meaning that its assets, or even the entire firm, may be transferred to a new owner. Outside investors may wish to buy the company, and the choice among offers implicates serious governance concerns. In insolvency, the fiduciary duty of loyalty expands to contemplate creditors as well as shareholders, and this has distributional consequences.² The fiduciary, be it an officer, director, trustee-in-bankruptcy, or debtor-in-possession, must frequently choose among buyers, or between sale and recapitalization. These choices may force the fiduciary to weigh an increased distribution to one group of creditors against a reduced distribution to another. Unfortunately, principles of fiduciary duty offer no useful solution to such problems of inherently divided loyalty.

Bankruptcy law provides a procedure for addressing such choices. The Chapter 11 plan confirmation process implements a supervised negotiation with the end-goal of either class acceptance or cramdown. The plan process encourages the flow of information and facilitates coordination among stakeholders in the shadow of statutory entitlements. In particular, class voting and the threat of cramdown minimize the power of holdouts who might choose to exploit the various forms of situational leverage that attend insolvency.³ In this regard, the Bankruptcy Code provides both a compliment to contract and a backstop to fiduciary duty.

Current bankruptcy practice offers two alternative mechanisms for effectuating changes of control: (1) a pre-plan all-asset sale under section 363(b) of the Bankruptcy Code; or (2) an asset sale or recapitalization pursuant to a plan of reorganization under section 1129 of the Code.⁴ Pre-plan sales under section 363(b) are fast, but lack the procedural protections associated with a restructuring or sale pursuant to a plan. Plan confirmation can be costly and uncertain; rescuing the business may be frustrated as claimants jockey for position.

In this Article, we consider restructuring support agreements (“RSAs”)—contractual agreements among creditors, and sometimes the debtor, to support restructuring plans that have certain agreed-upon characteristics. RSAs potentially offer a salutary bridge between the

directors to the creditors’ committee, the court, and other interested parties. This supervision structure addresses the fact it may not be immediately clear which particular creditor constituency holds the so-called fulcrum security—the residual claim against the reorganized debtor that will result in that constituency holding the equity of the reorganized debtor.

2. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Comm’n Corp.*, Civ. A. No. 12150, 1991 WL 277613, at *1155 (Del. Ch. Dec. 30, 1991) (“At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise.”); *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007). The contributions to this symposium of Henry Hu, Jay Westbrook, and John Pottow each address this issue.

3. *See* 11 U.S.C. §§ 1111, 1122, 1125, 1129 (2018).

4. 11 U.S.C. §§ 363(b), 1129 (2018).

efficiencies of a quick sale and the procedural protections of a plan, but they also pose a potential avenue for abuse of the bankruptcy process.

In our previous work, together and separately, we have explored the way the Bankruptcy Code deals (and could deal better) with behavior and coordination problems after the case has been filed.⁵ In this Article, we consider the dynamics of control both prior to the bankruptcy filing and after. We conclude that RSAs are an important tool in the restructuring toolkit. Indeed, we will suggest that sales or restructurings pursuant to an RSA and confirmed plan are, in most respects, superior to the alternative—an all-asset sale under section 363(b). Nonetheless there are reasons for concern, and we identify these as well.

Opportunism arises on both sides of negotiation in bankruptcy. Debtors may use the bankruptcy process to delay a creditor's exercise of its non-bankruptcy rights.⁶ But the Bankruptcy Code's process requirements exist precisely because creditor opportunism is a concern in insolvency as well.⁷ The debtor's vulnerability (and the vulnerable characteristics of certain types of creditors) can create opportunities for certain creditors to overreach.⁸

It is well understood that insolvency creates a variety of opportunities for creditors (and the debtor) to use situational leverage to influence the allocation of scarce assets.⁹ The exercise of such leverage comes in many forms: secured creditors may foreclose;¹⁰ depositories may engage in setoff;¹¹ key suppliers may threaten to stop supplying;¹² landlords can threaten to evict; unsecured creditors may get judgments and start grabbing assets;¹³ and purchasers may seek to take advantage of a depressed

5. See generally Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862 (2014) (discussing concerns with all-asset sales in bankruptcy, outside the context of a confirmed plan of reorganization); Edward J. Janger & Adam J. Levitin, *One Dollar, One Vote: Mark-to-Market Governance in Bankruptcy*, IOWA L. REV. (forthcoming 2019) (discussing the effect of derivatives and other hedging devices on the dynamics of plan confirmation).

6. THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 181–90 (2001).

7. Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 589, 611 (2015).

8. Jacoby & Janger, *supra* note 5, at 862; *In re Free Lance-Star Publ'g Co.*, 512 B.R. 798, 806 (Bankr. E.D. Va. 2014); *In re Humboldt Creamery, LLC*, No. 09-11078, 2009 WL 2820610, at *1 (Bankr. N.D. Cal. Aug. 14, 2009).

9. See, e.g., *In re The Free Lance-Star Publ'g Co.*, 512 B.R. at 806; *Solus Alt. Asset Mgmt. LP v. GSO Capital Partners L.P.*, No. 18 CV 232-LTS-BCM, 2018 U.S. Dist. LEXIS 13961, at *6 (S.D.N.Y. Jan. 29, 2018).

10. See, e.g., *In re Am. Lumber Co.*, 5 Bankr. 470, 478 (D. Minn. 1980); *Peerless Packing Co., Inc. v. Malone & Hyde, Inc.*, 376 S.E.2d 161, 164 (W.Va. 1988).

11. See, e.g., *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 18 (1995) (distinguishing a setoff from an asset-freeze).

12. See, e.g., *In re Kmart Corp.*, 359 F.3d 866, 868 (7th Cir. 2004) (invalidating a so-called "critical vendor" motion).

13. This is the so-called "race of diligence." See JACKSON, *supra* note 6, at 7–19.

valuation to purchase the company on the cheap.¹⁴ To the extent that the debtor has value as a going concern, individual creditors may have the power to hold such going concern value hostage by threatening to force liquidation. Alternatively, fully secured creditors may prefer a quick realization on their collateral, because they do not benefit from increasing the value of the firm.

The Bankruptcy Code seeks to limit these uses of situational leverage in a number of ways: (1) it stays unilateral creditor action (the automatic stay); (2) it allows for the unwinding of certain prepetition transfers (avoidance); (3) it sets a baseline distribution if the firm liquidates, but promises more if the firm can restructure (the allowed secured claim); (4) it creates a structured bargaining process that insures adequate information and reduces the ability of a creditor to holdout in the face of a reorganization plan that is supported by key creditor constituencies (supermajority acceptance); and (5) it sets an entitlement baseline if the firm reorganizes (cramdown).¹⁵ Bargaining in bankruptcy and on its threshold is, of course, informed by these procedural requirements and substantive entitlements, for if a deal is not reached, then liquidation will ensue.

In recent decades, a number of end-runs have been used to frustrate these procedural protections and reinstate situational leverage. On the front-end, sales of substantially all of the debtor's assets under section 363 can lock in a particular distribution without the protections of the plan process, either by fixing the value of the debtor on sale,¹⁶ or through the selective assumption of liabilities by the purchaser.¹⁷ As discussed below, these all-asset sales are sometimes effectively mandated by milestones included in debtor-in-possession financing agreements that are themselves an exercise of situational leverage.¹⁸

On the back-end, "gift" plans, rights offerings, and structured dismissals distribute value without complying with the Code's statutory priorities.¹⁹ RSAs are a useful tool for aiding the plan process, but they too must be scrutinized to ensure that they are not being used to further such

14. This is the intuition that animates the absolute priority rule. *See Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 442 (1999).

15. *See* 11 U.S.C. §§ 362, 544, 547, 548, 550, 726, 1129(a), 1122, 1125, 1126, 1129(b) (2018).

16. *See In re Lionel Corp.*, 722 F.2d 1063,1069 (2nd Cir. 1983).

17. *See Order (I) Authorizing the Sale of Substantially all of the Debtors' Assets Free and Clear of All Liens, Claims, Interests, and Encumbrances at 1, In re Chrysler LLC.*, No. 09-50002, 2009 WL 5131534, at *1 (Bankr. S.D.N.Y. June 1, 2009).

18. Debtors are desperate for liquidity and have little ability to negotiate terms if, as is frequently the case, substantially all of their assets are already encumbered. In such a situation, the existing secured creditor(s) have the ability to make a take-it-or-leave-it deal that the debtor is compelled to take in order to even have a shot at a restructuring, and these debtor-in-possession financing agreements frequently mandate sales or require them if rapid progress is not made toward plan confirmation.

19. *In re DBSD N. Am., Inc.*, 634 F.3d 79, 94 (2d Cir. 2011) (gift plans); *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 986 (2017) (structured dismissals).

behavior. Indeed, the Supreme Court raised concerns about such end-runs in *Czyzewski v. Jevic Holding Corp.*, where it held that structured dismissals could not deviate from the Code's statutory priorities.²⁰

RSAs are bargains, negotiated in contemplation of, or during, a bankruptcy case. In an RSA, key creditors commit to support the debtor's proposed plan of reorganization, provided that the plan satisfies certain broad characteristics. This allows the debtor to gather support for the business plan and distributional scheme it wishes to implement through Chapter 11 prior to the formal disclosure and solicitation process. Sometimes cases with RSAs are referred to as "prearranged" or "prenegotiated." As such, RSAs allow the debtor and key creditors to overcome coordination problems and to reorganize in the face of (and in anticipation of) holdouts.

Prearranged bankruptcies differ from so-called "prepackaged" bankruptcies in that actual votes on a plan are not solicited. Instead, in a prearranged bankruptcy, certain creditors commit to supporting a plan by signing onto an RSA proposed by the debtor.²¹

RSAs are structured as agreements among the creditors; the petition debtor may or may not be a party. If so, then sometimes (but not always), the debtor may seek to assume the agreement once the petition is filed. In most cases, RSAs are subject to a so-called "fiduciary out" provision that allows the debtor to exit the arrangement if a superior deal presents itself.²² Viewed this way, RSAs appear harmless. Indeed, they seem a relatively transparent mechanism for bringing order to a complex and difficult situation.

There is concern, however, that RSAs might be used opportunistically, to exploit situational leverage in order to reallocate value and thus favor one investor constituency over others. Indeed, the fact that RSAs are sometimes referred to as "lockup" agreements highlights this concern.²³ Once an RSA is proposed and supported by key constituencies, the costs of opposing the contemplated plan are prohibitive for most creditors. The proposal may operate as a *fait accompli*. If the RSA freight train is being used to stop

20. *Jevic*, 137 S. Ct. at 986 ("[T]he distributions at issue here more closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards.").

21. John D. Ayer et al., *Out-of-court Workouts Prepacks and Pre-arranged Cases A Primer*, AM. BANKR. INSTIT. J. (Apr. 1, 2005), available at <https://www.abi.org/abi-journal/out-of-court-workouts-prepacks-and-pre-arranged-cases-a-primer>.

22. Morris Massel, *How To Negotiate A Ch. 11 Plan Support Agreement*, LAW360 (Oct. 16, 2013, 4:37 PM), <https://www.stblaw.com/docs/default-source/cold-fusion-existing-content/publications/pub1651.pdf?sfvrsn=2>.

23. See Doron P. Kenter, *No Soliciting? Delaware Court Holds that Restructuring Support Agreement Does Not Constitute Premature Solicitation Warranting Designation of Votes*, WEIL GOTSHAL & MANGES LLP BANKR. BLOG (Feb. 13, 2013), <https://business-finance-restructuring.weil.com/chapter-11-plans/no-soliciting-delaware-court-holds-that-restructuring-support-agreement-does-not-constitute-premature-solicitation-warranting-designation-of-votes/>.

creditors from developing information or identifying bases for objection, the device becomes problematic.

The difficulty is distinguishing beneficial RSAs from harmful ones. In that regard, we seek to articulate a set of principles for distinguishing one from the other. Accordingly, we suggest a number of “badges of opportunism”—red flags in an RSA that act much like the “badges of fraud,” that are used to identify fraudulent transfers.²⁴ We also suggest a procedural device for helping to sort among RSAs. Finally, we compare RSAs to all-asset sales under section 363 of the Bankruptcy Code. Because RSAs contemplate a confirmed plan, we view them as broadly preferable to sales under section 363. However, as noted below, the distinction is often not quite as clear as one might like. Nonetheless, we are able to articulate what we see as a fundamental norm of chapter 11 that guides RSAs, sales, and a range of other transactions: the common interest in value maximization may not be held hostage by a creditor seeking to improve its own priority.

This Article is divided into five parts. First, we describe the practice surrounding restructuring support agreements and identify some of the anecdotal concerns raised. Second, we catalogue the good and bad in RSAs. Third, we offer some examples that illustrate how to distinguish the good from the bad by focusing on bargaining in the shadow of entitlements. We link RSAs to the lesson of *Jevic*, which cautions against “end-runs” around the plan process.²⁵ Fourth, we flesh out the concept of an end-run around the plan process in the context of an RSA and identify certain “badges of opportunism.” Specifically, we are concerned with provisions in an RSA that hold value maximization hostage to a reordered priority scheme. Finally, we consider corporate control transactions in bankruptcy in light of this analysis. The guiding principle, we suggest, in evaluating corporate control transactions in bankruptcy should be to prevent a reordering of priorities through the threat of value destruction.

I. WHAT ARE RESTRUCTURING SUPPORT AGREEMENTS?

It is well understood that the success of a Chapter 11 restructuring is often dependent on the extent to which it is preplanned. It is difficult for a firm that “free falls” into bankruptcy to confirm a plan that continues the business. Planning helps. If the debtor can pre-vet its proposed plan for exiting bankruptcy with key creditor constituencies, the likelihood of a successful outcome increases.²⁶ There is a spectrum of planning possible,

24. UNIFORM FRAUDULENT TRANSFERS ACT § 4(b) (UNIF. LAW COMM’N 2014).

25. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 986 (2017) (“[T]he distributions at issue here more closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code’s procedural safeguards.”).

26. Compare *Lehman Brothers*, which stumbled into bankruptcy when the Federal Reserve Bank declined to bail it out, Anne Sraders, *The Lehman Brothers Collapse and How It’s Changed*

from a mere proposal to a “prearranged” case to a “prepackaged” case. A prepackaged case involves a formal and binding solicitation of creditor votes prior to filing. The debtor files for bankruptcy only after it has procured votes from the requisite majorities in each impaired class necessary to confirm the plan. Plan confirmation can then be expedited, and the case can be completed quickly.

In contrast, a prearranged case involves a lesser degree of creditor buy-in. In a prearranged case, key creditor constituencies agree only to support a plan that meets certain characteristics. They do not sign off on an actual plan (for no actual plan yet exists), and their votes are not formally solicited.

The device by which prearrangement is achieved is through a so-called Restructuring Support Agreement or RSA, that is sometimes also called a “Plan Support Agreement” or PSA.²⁷ The agreement may be solely among key creditor constituencies, or it may include the debtor as a party. If the debtor is a party, then after filing the debtor may formally “assume” the agreement under section 365 of the Bankruptcy Code or, in the alternative, will simply perform it without assumption, even if it could not be formally held to performance. RSAs are entered into both prepetition and postpetition.

There is nothing intrinsically problematic with an RSA, so long as:

- (1) the debtor does not commit to do anything that it does not (or should not) have the power to do; and
- (2) the agreement is not used in order to undercut the substantive policies and procedural protections of the Bankruptcy Code.

In fact, RSAs can be quite helpful. If a debtor has sought to restructure outside of bankruptcy, but has failed due to the stubbornness of a holdout or a few holdouts, the Bankruptcy Code’s class voting mechanism and cramdown procedure can both bind dissidents to the restructuring, as can the cram-up technique of disenfranchising a holdout by leaving it

The Economy Today, THE ST. (Sept. 12, 2018), <https://www.thestreet.com/markets/bankruptcy/lehman-brothers-collapse-14703153>, with Order (I) Authorizing the Sale of Substantially All of the Debtor’s Assets Free and Clear of All Liens, Claims, Interests, and Encumbrances, (II) Authorizing the Assumption and Assignment of Certain Executory Contracts and Unexpired Leases in Connection Therewith and Related Procedures and (III) Granting Related Relief, *In re Chrysler LLC.*, No. 09-500002, 2009 WL 5131534, at *1 (Bankr. S.D.N.Y. June 1, 2009) (demonstrating the debtor entered bankruptcy with a clear idea of how it planned to emerge).

27. See, e.g., *In re Caesars Entm’t Operating Co., Inc.* 533 B.R. 734 (Bankr. N.D. Ill. 2015), *rev’d on other grounds*, 808 F.3d 1186 (7th Cir. 2015). *In re Innkeepers USA Trust*, 442 B.R. 227, 235 (Bankr. S.D.N.Y. 2010); *In re Genco Shipping & Trading Ltd.*, 513 B.R. 233, 239 (Bankr. S.D.N.Y. 2014); *In re Indianapolis Downs, LLC*, 486 B.R. 286, 292 (Bankr. D. Del. 2013); Memorandum Opinion Approving the Plan Support Agreement, *In re Residential Capital, LLC*, 12-12020, 2013 WL 3286198, at *20 (Bankr. S.D.N.Y. June 27, 2013), *In re Kellogg Square P’ship*, 160 B.R. 336, 341 (Bankr. D. Minn. 1993).

unimpaired.²⁸ But the work done prepetition should not be lost. There is certainly nothing to be gained by reinventing the wheel. So, to the extent that key creditors have signed off on the outlines of a restructuring prepetition, the RSA allows the debtor to carry that support into bankruptcy.²⁹

RSAs present risks, however. When a debtor is in financial difficulty, negotiations with creditors outside of bankruptcy (or early in the case) can be highly dysfunctional.³⁰ Certain key creditors may exploit transactional or situational leverage to enhance their distribution at the expense of others.³¹

A central goal of bankruptcy is, therefore, to try to separate questions of value maximization from questions of value distribution. Where value distribution is involved, the Code imposes several procedural requirements that both preserve the integrity of the negotiations and assure proper flow of information to stakeholders. Where RSAs further the goals of this process they are beneficial. Where they seek to short circuit it, they are not.

II. THE GOOD AND THE BAD OF RSAS

A. THE GOOD

When a debtor is insolvent and has multiple creditors, it can be devilishly difficult to negotiate a workout.³² In the absence of the ability to impose forbearance (a stay) and discharge, each creditor has the power to frustrate the agreement and an incentive to do so. Public choice theorists have long understood that attempts to divide a fixed pot of money are subject to a prisoner's dilemma.³³ Each individual creditor has an incentive to frustrate the agreement and grab all the reorganization value for themselves, but if this happens synergistic value of the firm may be lost.

The Bankruptcy Code introduces five features (noted above) to counteract this dynamic: (1) the automatic stay;³⁴ (2) the ability to avoid

28. See 11 U.S.C. §§ 1126, 1129 (2018).

29. It is important that the support be obtained based on adequate information. In this regard, the securities laws may impose some discipline before filing the petition, and 11 U.S.C. § 1125 (2018) may do so after.

30. See *In re Fisker Auto Holdings, Inc.*, 510 B.R. 55, 60–61 (Bankr. D. Del. 2014); *In re Free Lance-Star Publ'g Co.*, 512 B.R. 798, 805 (Bankr. E.D. Va. 2014); *In re Humboldt Creamery, LLC*, No. 09-11078, 2009 WL 2820610, at *2 (Bankr. N.D. Cal. Aug. 14, 2009).

31. *Solus Alt. Asset Mgmt. LP v. GSO Capital Partners L.P.*, No. 18 CV 232-LTS-BCM, 2018 U.S. Dist. LEXIS 13961, slip op. at 1 (S.D.N.Y. Jan. 29, 2018) (noting that bonds refinance on favorable terms in return for a payment default that constituted a “Credit Event” under certain credit default swaps).

32. M. MORITZ & B SEAMAN, *GOING FOR BROKE: THE CHRYSLER STORY* Ch. 13 (1981).

33. See generally KENNETH A. SHEPSON, *ANALYZING POLITICS: RATIONALITY, BEHAVIOR, AND INSTITUTIONS* (2d. ed. 2010) (explaining the idea about empty core and the divide of the dollars claim); see Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 *YALE L.J.* 648, 687 (2010).

34. 11 U.S.C. § 362 (2018).

certain prepetition transfers;³⁵ (3) a structured bargaining process that insures adequate information;³⁶ (4) the power to bind minority holdouts pursuant to a consensual plan;³⁷ and (5) the establishment of an entitlement baseline³⁸ for all creditors. The goal is to facilitate and structure the negotiations over the reorganization surplus and deprive individual creditors of the ability to unilaterally frustrate a favorable deal.

RSAs allow the debtor to bargain in the shadow of liquidation or cramdown toward a consensual confirmation. Such bargaining can occur pre-filing, post-filing or both.³⁹ An RSA can have important positive effects on prebankruptcy negotiations. It may forestall the race of diligence and make it more possible to negotiate a restructuring outside of bankruptcy. Indeed, it may provide the same “breathing period” created by the automatic stay without the need to file for bankruptcy, reducing holdout leverage even before the filing.

While RSAs are negotiated without the procedural protections associated with the plan process and may involve fewer than all of the interested parties, RSAs do not necessarily foreclose or preclude the usual procedural protections associate with the plan process. RSAs typically contain a “fiduciary out” provision, under which the debtor may exit the agreement if a more favorable offer arises. Moreover, the plan will ultimately be subjected to judicial approval, following the usual rules for disclosure, solicitation, and class voting.

B. THE BAD—OR, AT LEAST, WORRISOME

Just as the RSA may allow the debtor to carry some of the benefits of bankruptcy into a prebankruptcy negotiation, and may facilitate bargaining within bankruptcy, the RSA may allow a creditor to carry its prebankruptcy leverage into the bankruptcy case. This is where RSAs can become troubling and troublesome.

1. Participation and the *Fait Accompli*

First, as noted above, the negotiation of RSAs can take place in a multilateral or a bilateral environment, or a combination. This means that the agreement of key constituencies can be procured first, and then the agreement can be presented to less powerful constituencies as a *fait*

35. 11 U.S.C. §§ 544, 547, 548 (2018).

36. 11 U.S.C. § 1125 (2018).

37. 11 U.S.C. § 1129(a) (2018).

38. 11 U.S.C. § 1129(b) (2018).

39. Order, *In re* NII Holdings Co. Inc., No. 02-11505 (Oct. 25, 2002) ECF No. 367; Order Confirming Debtor’s Second Amended Plan of Reorganization Pursuant to Chapter 11 of the Bankruptcy Code at 7, *In re* Stations Holdings Corp., No. 02-10882(MFW) (Bankr. D. Del. Sept. 30, 2002), ECF No. 178.

accompli, leaving them little choice but to accept.⁴⁰ Indeed, it is not unknown for adherence to the RSA to be procured through an offer that imposes differential (“deathtrap”) treatment on those who reject.⁴¹ This was an issue raised in the *Caesars Entertainment*⁴² bankruptcy among others.

Some of these concerns are remedied where it is anticipated that the case will be completed through a confirmed plan of reorganization, or a sale pursuant to a plan. In those cases, the bankruptcy court is given an opportunity to police notice, ensure the adequacy of information, and consider objections. These objections may address whether the plan was proposed in good faith, whether the votes were cast in good faith, and whether any discriminatory treatment proposed in the plan can pass muster.

2. Information/Timing

RSAs also raise concerns about information and timing. When support is sought prepetition, the debtor and key proponents of the plan often hold all of the informational cards about the business. The debtor has been operating the company. If there is a purchaser, they may have had months to perform due diligence. The creditors whose support is sought are at a considerable disadvantage. A post-petition solicitation of votes requires the dissemination of a disclosure statement to the voting stakeholders.⁴³ The Bankruptcy Code forbids the dissemination of a disclosure statement, however, unless a court has first found that it contains “adequate information.”⁴⁴ There is no prepetition equivalent requirement for disclosures of any sort, much less a merit regulation regime of disclosures. At best, the adequacy of prepetition disclosure is policed *ex post* by federal and state securities laws (when a security is involved), unfair and deceptive acts and practices statutes, and common law fraud.

While bankruptcy courts actively supervise disclosure, prepetition negotiations do not benefit from this leveling of the informational playing field. In this regard, RSAs should be subject to termination if there is a material change, or information provided turns out to be inaccurate or incomplete. Indeed, when an RSA is negotiated post-petition, it is important that the term sheet not cross the line into the solicitation of a vote,⁴⁵ and

40. See William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597 (2018) (describing similar tactics in out-of-court bond restructurings).

41. Massel, *supra* note 22.

42. Sujeet Indap, *What happens in Vegas...the messy bankruptcy of Caesars Entertainment*, FIN. TIMES (Sept. 26, 2017), <https://on.ft.com/2jYu8PD>; Joseph Checkler & Tom Corrigan, *Judge Approves LightSquared's Restructuring Proposal*, WALL ST. J. (Mar. 26, 2015, 5:16 PM), <https://on.wsj.com/2tl1hGZ>.

43. 11 U.S.C. § 1125(b) (2018).

44. *Id.*

45. See *In re Indianapolis Downs, LLC*, 486 B.R. 286, 293 (Bankr. D. Del. 2013); *Century Glove, Inc. v. First Am. Bank of New York*, 860 F.2d 94, 102 (3d Cir. 1988).

even more important that it not displace the protections associated with the disclosure and solicitation process.⁴⁶

The timing of negotiations can also have a coercive effect.⁴⁷ Insolvency always imposes time pressure, but the debtor and key plan proponents have power over the timing of the bankruptcy filing.⁴⁸ As Jacoby and Janger discuss, debtors are often melting ice cubes, and crisis timing can be used as leverage to coerce agreements that violate Code priorities or lock in a sweetheart deal.⁴⁹ RSAs can accomplish such a lock in, as can debtor-in-possession financing agreements.

3. Distribution

Any bankruptcy case must address both value maximization and value distribution. The Bankruptcy Code seeks to give management a breathing spell to fix the business or to sell it as a going concern at a fair price. Insolvency creates a crisis that can force liquidation at a fire sale price.⁵⁰ The Bankruptcy Code seeks to relieve this crisis pressure so that an appropriate decision can be made about how to maximize value: is the firm worth more as a going concern or piecemeal? Are the assets worth more when placed in a new capital structure or through a rejiggering of the existing capital structure?

The Bankruptcy Code also creates a structured process for negotiating a fair distribution of value in the shadow of statutory entitlements.⁵¹ The process of plan negotiation offers non-consenting creditors procedural protections as a condition of imposing a haircut.⁵² Any technique that allows a creditor to use situational crisis leverage created by insolvency to bind the debtor or other creditors after the petition is filed is a danger. In bankruptcy, there are rules for soliciting votes.⁵³ Outside of bankruptcy, those protections are much weaker. For companies with registered securities, federal securities laws come into play, but for non-public companies, there are often effectively no laws governing the solicitation of consents.⁵⁴

46. 11 U.S.C. § 1125 (2018); Jacoby & Janger, *supra* note 5, at 896.

47. *Id.*

48. *Id.* at 902.

49. *Id.* at 867; Stephen Fraidin & Jon D. Hanson, *Toward Unlocking Lockups*, 103 YALE L.J. 1739, 1742 (1994).

50. *See generally* Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1 (2007) (noting that recoveries in restructurings exceed those in going concern sales).

51. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 976–77 (2017).

52. 11 U.S.C. §§ 1122, 1125, 1126, 1129 (2018).

53. *Century Glove, Inc. v. First Am. Bank of New York*, 860 F.2d 94, 97 (3d Cir. 1988).

54. The protections lie in the disclosure regulations contained in the 1933 and 1934 Act. Securities Act of 1933. *See* 15 U.S.C. § 77a (2019); 15 U.S.C. § 78a (2018). State blue sky laws sometimes have broader definitions of security than federal law and may, therefore, cover some prepetition solicitations of votes. *See, e.g.*, OHIO REV. CODE ANN. § 1707.01(B) (2015) (defining security as including, among other things, “promissory notes,” “evidences of indebtedness,” “any

4. The Inadequacy of the Fiduciary Out

A common mechanism for guarding against these concerns is the so-called “fiduciary out” clause.⁵⁵ Where a deal is being approved, the debtor’s support is subject to “higher and better.” In other words, if a better deal comes along, the debtor can terminate the RSA. This is an important protection, but it is inadequate. The problem lies in defining “better.” As Professors Hu and Westbrook have pointed out, fiduciary duties are not particularly helpful in insolvency.⁵⁶ When a debtor is insolvent, or in the zone of insolvency, officers and directors serve two masters. They may, but are not required to, consider both shareholder interests and creditor interests.⁵⁷ If the debtor is actually insolvent, the problem becomes even more acute. Multiple tranches of investors, and often multiple asset-based or entity based distributional waterfalls come into play. The fiduciary may seek to maximize the value of the firm (a higher-value offer), but if achieving the best price carries different distributional consequences, the fiduciary is not in any position to decide whether one offer is actually better than another.

Also, most firms are structured as multi-entity corporate groups. Some or all of the members of the group will typically file together and have their cases jointly administered. Questions arise as to whether separate plans, each with separate disclosure, solicitation and voting are necessary. Similarly, there are questions of whether intercompany claims should be subordinated or waived, or whether the entities should be substantively consolidated for voting or distributional purposes. In these cases, a fiduciary is not serving just two masters, but a host of them, a situation similar to the “tranche warfare” dilemma for securitization trustees considering the restructuring of securitized assets.⁵⁸ The debtor-fiduciary essentially faces a centrifuge, in which its duties are simultaneously pulling it in all directions.

The debtor-fiduciary’s centrifugal problem is particularly acute where there is a dispute between secured creditors who have priority in assets, and

agreement evidencing a promise or an agreement to pay money,” “warehouse receipts for intoxicating liquor,” and “the currency of any government other than that of the United States and Canada”).

55. William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 BUS. L. 653, 653 (2000).

56. See generally Henry T. C. & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, 107 COLUM. L. REV. 1321, 1324 (2007).

57. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc’ns Corp.*, 1991 WL 277613, at *1155 (Del. Ch. Dec. 30, 1991); *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007).

58. See, e.g., Robert J. Coughlin & Ripley E. Hastings, *Survival Skills Amid the Rubble: Life as a Trustee in a Market Collapse*, 16 J. STRUCTURED FIN. 37, 42 (2010). A related problem is when a securitization trustee is trustee for multiple securitization trusts that each have put back claims against a securitization sponsor. The trusts have adverse interest to each other as they are competing for the sponsor’s finite pool of assets.

general unsecured creditors who have a claim against the residual value of the firm. A sale of a specific asset will lock in the asset's value, which is in the interest of a creditor secured by that collateral, but it may also destroy the firm's going concern value to the detriment of the general unsecured creditors.⁵⁹

This is problematic. While secured creditors are often colloquially thought of as "senior" to unsecured creditors, their priority rights are, in fact, limited to their collateral; they have no general security in the "value" of the firm as an operating entity. If a secured creditor's collateral turns out to be inadequate to repay its debt, that creditor's deficiency claim is treated as a general unsecured claim. In such a situation the creditor's interest in maximizing (or at least locking in) the value of the collateral-based distribution may be in tension with the interest of the unsecured creditors in maximizing the value of the firm. Worse yet, it is possible that an offer may come along that increases the overall value of the firm but allocates all of the increase to the secured creditors, or actually reduces the recovery to the unsecured (or vice versa). There is no obvious way for a debtor-fiduciary to navigate this thicket.

All of this is to say that when the debtor is a fiduciary for these disparate interests, the conflicts are inherent, and there is no obvious right solution. The "fiduciary out" is, therefore, an inadequate solution to the risks posed by RSAs.

5. RSAs and the Problem of Procedural End-Runs

RSAs, thus, exist in a world where fiduciary duties will not effectively guide the debtor in making distributional choices and where judges are not in a position to intervene. Therefore, RSAs must be viewed against the backdrop of the plan confirmation process. The basic intuition behind the section 1129 of the Bankruptcy Code, is that a plan of reorganization can be confirmed if it complies with certain statutory entitlements: (1) secured creditors receive the value of their liens; and (2) unsecured creditors receive the unencumbered value of the firm according to the statutory priority waterfall.⁶⁰ If the debtor and the creditors wish to deviate from these entitlements, they must comply with the procedures for consensual confirmation of a plan.⁶¹ These include disclosure requirements, voting procedures, and, ultimately the requirement of the consent to the plan of statutory majorities of all impaired classes of creditors.⁶²

59. For this reason, courts will not lift the stay in bankruptcy to sell an asset that is essential to reorganization, even if the liens against it exceed its value. 11 U.S.C. § 362(d)(2) (2018).

60. 11 U.S.C. § 1129(b) (2018).

61. *See* 11 U.S.C. §§ 1122, 1125, 1126, 1129(a) (2018).

62. *Id.*

The Supreme Court has recently raised concerns about devices that use procedural shortcuts to evade this structure. In *Jevic*,⁶³ a debtor proposed a so-called “structured dismissal” under which the debtor would, in effect, settle a case, but then pursuant to the dismissal order distribute funds in a manner that deviated from the prescribed statutory waterfall for a liquidation or cramdown plan.⁶⁴ Specifically, the litigant specified that priority wage claimants would not receive a distribution, while unsecured, non-priority, creditors would.⁶⁵ While deviations from statutory (sometimes called “absolute”) priority are permitted under a consensual plan, they are not permitted in cramdown.⁶⁶ The Supreme Court held that the structural dismissal device could not be used as an end-run around the plan confirmation process.⁶⁷

The Court noted that there are numerous decisions made during the course of a bankruptcy case that affect distribution, from asset sales, to motions to pay certain critical vendors, to curing defaults under assumed contracts.⁶⁸ The permissible examples given were all approved without objection, or where deviation was found to benefit the estate as a whole. The Court was careful to distinguish such situations that could be justified by mere “sufficient reasons,” and cautioned against devices that operate as *sub rosa* plans absent a “significant offsetting bankruptcy-related justification.”⁶⁹

RSAs are preferable to most of these devices in that they contemplate a plan of reorganization that will be subjected to the full panoply of procedural protections and approved by the requisite majorities. RSAs, however, are also sometimes referred to colloquially as “lockup” agreements. In that regard, RSAs can also be used to end-run the plan process and, as such, raise concerns.

III. USE OF RSAS TO END-RUN THE PLAN PROCESS

A number of recent cases provide examples of controversial uses of RSAs, and how courts have dealt with them. The concerns have involved: (1) RSAs as solicitations; (2) coercive features within RSAs; and (3) milestones (in particular when linked to section 363 sales).

A. SOLICITATIONS

The first area of concern is the need to safeguard the voting procedures contemplated by the plan confirmation process. Two Delaware bankruptcy

63. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 973 (2017).

64. *Id.* at 976.

65. *Id.* at 981.

66. 11 U.S.C. § 1129(b)(B)(ii) (2018).

67. *Jevic*, 137 S. Ct. at 983.

68. *Id.* at 985–86.

69. *Id.*

cases have raised concerns about RSAs entered into post-petition. In 2002, in both *NH Holdings* and *Stations Holding*, the bankruptcy court designated (that is disqualified) the votes of creditors who had signed on to a post-petition RSA for having improperly solicited votes on a plan.⁷⁰ The court saw the solicitation of signatures to an RSA, promising to support the plan, as tantamount to solicitation of votes for the plan. This risk of designation creates a difficult tension between prepackaged plans, where votes are solicited prepetition, regulated (if at all) by the securities laws, and the rules governing negotiations prior to and within bankruptcy over a plan.

A more recent case out of Delaware, sought to manage that tension by construing the definition of solicitation narrowly. In *Indianapolis Downs*,⁷¹ the court looked to an earlier Third Circuit case, *Century Glove*,⁷² that limited the prohibition on solicitations to actual solicitations. The court recognized that the *sine qua non* of Chapter 11 is negotiation; the debtor needs the freedom to seek support for its proposed plan without risking vote designation.

That said, there remains considerable uncertainty about when seeking an expression of support shades into solicitation of a vote, and when the RSA crosses the line from term sheet to lock up or *sub rosa plan*. When does an RSA cross the line from serving the purposes of Chapter 11 to frustrating them? The key here seems to be the existence of meaningful escape hatches, such as fiduciary out provisions (that run to all the signatories, not just the debtor), as well as “no material modification” provisions that allow signatories to exit if a better deal appears or if projections on which the RSA is predicated turn out to be inaccurate. It is also important that the RSA be structured in such a way that, at the time of voting, the signatories will have a meaningful choice to make.⁷³

B. COERCIVE FEATURES

A second possible “end-run” around the confirmation process arises through the use of coercive features in securing plan support. One way of doing this is to offer creditors who vote in favor of the plan better treatment than those who reject it. This technique was at issue in two recent and prominent cases, *Caesars Entertainment*,⁷⁴ in the Southern District of New York, and *Marblegate*⁷⁵ in the Second Circuit. In those cases, non-

70. See, e.g., *In re NH Holdings, Inc.*, 288 B.R. 356, 362 (Bankr. D. Del. 2002) (designating votes cast under lock-up agreement executed postpetition); *In re Stations Holding Corp.*, No. 02-10881(MFW), 2002 WL 31947022, at *3 (Bankr. D. Del. Sept. 30, 2002).

71. *In re Indianapolis Downs, LLC*, 486 B.R. 286, 294 (Bankr. D. Del. 2013).

72. *Century Glove, Inc. v. First Am. Bank of New York*, 860 F.2d 94, 101–03 (3d Cir. 1988).

73. As we will discuss below, this may be because, in the case of a sale, assets have not yet been distributed, or because the business remains intact.

74. *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entt Corp.*, 80 F. Supp. 3d 511 (S.D.N.Y. 2015).

75. *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, 846 F.3d 1 (2d Cir. 2017).

bankruptcy restructurings granted bondholders who tendered their bonds into the restructuring a distribution, while leaving the non-tendering bondholders their unimpaired rights against bonds that were rendered worthless.⁷⁶ This practice was challenged under section 316(b) of the Trust Indenture Act (TIA), but the Second Circuit held that, so long as the core payment terms of the bonds were left unchanged, the TIA was not violated.⁷⁷ The Second Circuit pointed out that some of the things done to effectuate the practical impairment might be challenged under other bodies of law, but not the TIA.⁷⁸

While the transactions in both *Marblegate* and *Caesars* occurred outside of bankruptcy, they still involved the use of a restructuring agreement, and can be understood as analogous to the bankruptcy RSA issue. The concern here is the use of a coercive exchange offer to effectively force bondholders to join in the RSA and accept the plan. A creditor who votes to reject a proposed plan of reorganization always faces the risk that the failure of its class to accept the plan will force the debtor to liquidate and that it will therefore receive less. These coercive terms magnify that effect. The question for us is whether such coercive techniques should be used in an RSA. It is one thing for the bondholders to agree to a particular treatment. It is another for them to be levered into it at the RSA stage, thereby rendering the plan process irrelevant.

C. MILESTONES

There is a separate aspect of the RSA that can be both helpful and problematic. RSAs are usually thought of as focusing on the content of the plan and actions to be taken by the debtor post-confirmation. RSAs, however, can also govern the conduct of the debtor during the case, on the way to confirmation. Like DIP financing agreements, RSAs frequently contain “milestones” which require the debtor to achieve certain points in the restructuring by certain deadlines. In RSAs, if the milestones are missed, then either the signatories are excused from supporting the plan, or the debtor commits to an alternative course of action. As a result, milestones can assure that the proposed business plan progresses toward consummation. But milestones can also lock in a *fait accompli*, assuring that by the time of confirmation there is no meaningful alternative.

An example of a troublesome use of milestones in an RSA can be found in the *Walter Energy* case.⁷⁹ In that case the RSA provided for a debt to

76. *Id.* at 4.

77. *Id.* at 17.

78. *Id.* at 16–17.

79. *In re Walter Energy, Inc.*, 542 B.R. 859 (Bankr. N.D. Ala. 2015), *aff'd sub nom.* United Mine Workers of Am. Combined Benefit Fund v. *Walter Energy, Inc.*, 551 B.R. 631 (N.D. Ala. 2016), *and aff'd sub nom.* United Mine Workers of Am. 1974 Pension Plan & Tr. v. *Walter*

equity swap that would have given the secured creditors control of the company.⁸⁰ The RSA also provided for a seven month drop dead date, under which, if the plan was not consummated, there would be a section 363 sale of the company, where the first lien lenders would credit bid their debt and purchase the company.⁸¹ When the debtor sought to assume the RSA, numerous creditors objected and the deal fell apart, but this is a rather extreme example of a creditor's attempt to use an RSA to lock up the case.⁸²

By contrast, *Indianapolis Downs*⁸³ contained a less troublesome use of milestones. It provided an opportunity for the debtor to test the market and shop the company. If that failed, it provided an outline for a recapitalization. The effect of this structure was to, in effect, set a reserve price for an auction of the company. As one of us has discussed elsewhere,⁸⁴ such auctions can have similar lock-up and bid chilling features, but here a successful outside bid was received. While there may have been other issues with the *Indianapolis Downs* RSA, the milestone here does not appear to have been a problem.

In sum, the issue with milestones is not the milestones themselves, but whether they are being used as to accomplish an end-run around the plan confirmation process.

IV. END-RUNS: *SUB ROSA* PLANS AND THE BADGES OF OPPORTUNISM

Thus far we have seen that the concerns about RSAs do not lie in the RSAs themselves, but in how they are being used. It remains unclear whether RSAs are being used as an aid to or a substitute for plan confirmation. It remains unclear whether RSAs facilitate bargaining in the shadow of liquidation or cram-down, or if they effectuate a transfer of reorganization surplus to a particular constituency without meaningful review.

The key question in thinking about RSAs, and the dividing line between the good and the bad, is whether an RSA is being used to overcome coordination problems, or whether it is being used to exploit situational leverage in order to hold the resolution of value maximization issues hostage to redistributive demands. Is an RSA facilitating the bargaining in the shadow of entitlement that the Bankruptcy Code contemplates? Or is it facilitating opportunistic distortion of the Code's priority scheme or process

Energy, Inc., 579 B.R. 603 (N.D. Ala. 2016), *aff'd sub nom. In re Walter Energy, Inc.*, 911 F.3d 1121 (11th Cir. 2018).

80. *Id.* at 869.

81. *Id.*

82. *Id.*

83. *In re Indianapolis Downs, LLC*, 486 B.R. 286, 294 (Bankr. D. Del. 2013).

84. Jacoby & Janger, *supra* note 5, at 867.

for policing bargains through plan confirmation? We suggest some “badges of opportunism” that can be used as a rubric for identifying when RSAs are problematic.

The badges of opportunism come in two flavors, procedural and distributive, though the two are often linked. On the distributive side, a clear sign of opportunism is when an RSA is used to reallocate reorganization surplus to its supporters. Thus, certain provisions in an RSA such as those that waive preference or fraudulent conveyance recoveries, that release third parties, that waive section 506(c) charges, or that enforce structural subordinations, should send up red flags as badges of opportunism.

On the procedural side, badges of opportunism are present in provisions that:

- (1) reward the signer of the RSA at the expense of non-signers, particularly where the non-signers are in the same class or a junior class (unless disinterested members of the junior class also support the plan); or
- (2) seek to commit parties to supporting a plan notwithstanding later developments in the case.

Thus, the absence of a fiduciary out or a no-material modification provision might be fatal. Similarly, coercive features, such as those used in *Caesars* and *Marblegate*, ought to be carefully scrutinized with an eye toward whether they are being used in good faith.

Finally, and this bears particular mention, where an RSA provides for a sale of the company, the distributive and procedural concerns are magnified because the sale will be accomplished well before the plan process—the Bankruptcy Code’s contemplated mechanism for policing bargains—can be completed. Therefore, the distributive questions in a sale should be subject to the procedural protections associated with the plan process or the equivalent.

Janger and Jacoby have described a relatively straightforward way to accomplish this—the Ice Cube Bond, described below.⁸⁵ If there is to be a sale of substantially all the debtor’s assets outside the context of a confirmed plan, sufficient assets should be retained in the estate to assure that any distribution will satisfy the statutory requirements for “cramdown.”⁸⁶

There are two distinct ways that an RSA can be used to facilitate a sale that is an end-run around the plan process. First, the RSA can simply contemplate a sale of the firm under Section 363. This approach appears relatively rare, although nothing prevents it. Second, the RSA could use milestones that, while contemplating a plan on paper, are really being used

85. See generally Jacoby & Janger, *supra* note 5 (describing the Ice Cube Bond).

86. 11 U.S.C. § 1129(b) (2018).

to get approval of a 363 sale to a stalking horse or credit bidding lender. This might occur where the contemplated plan is a Hail Mary, or where the sale contemplated by the termination event contains a prearranged distribution or strike price or agreed credit bid.

In effect, the RSA may call upon the creditor to support a sale of substantially all of the assets of the debtor under section 363(b) of the Code.⁸⁷ In such cases, the value of the firm can be distributed pursuant to the sale order without the procedural protections associated with plan confirmation, including the assumption of select liabilities that are effectively elevated in priority by their assumption.⁸⁸ Such sales have been challenged as *sub rosa* plans, in that the terms of the sale dictate the distribution to the various creditor constituencies without complying with the procedural protections associated with confirmation of a consensual plan of reorganization.⁸⁹ They can be used to present a *fait accompli* to both creditors and to the judge.⁹⁰ Where this is the case, the RSA is an important piece of the puzzle, limiting the ability of dissenting constituencies to organize and/or raise objections.⁹¹

V. RESTRUCTURING SUPPORT AGREEMENTS AND CHANGE OF CONTROL: 363 SALES, *JEVIC* AND THE *ICE CUBE BOND*

Returning to the change of control transactions in bankruptcy, we must consider RSAs in the context of the two alternative mechanisms for effectuating a change of control in Chapter 11: (1) the sale of the company pursuant to a confirmed plan of reorganization; and (2) the sale of the company pursuant to an all-asset going concern sale under section 363(b).

As Janger and Jacoby have written, hurry-up all-asset sales under 363 are sometimes a necessary shortcut, where the debtor truly is a “melting ice cube” and a quick sale is necessary to preserve its value.⁹² Where this is the case, the court must assure itself that crisis leverage is not being used to undercut the Bankruptcy Code’s distributional scheme.

Just like 363 sales, RSAs are useful as long as their limits are recognized. To the extent that an RSA ensures that a consensual sale can be achieved and subjected to the consensual plan confirmation process, it is a useful tool. To the extent that an RSA is used to prevent scrutiny of a particular sale or modification to the distributional scheme it is problematic. In the absence of a confirmed plan of reorganization, there should be a

87. For a recent example, see Erik Larson, *Journal Register Approved to Sell Assets in Bankruptcy Court*, BLOOMBERG (Mar. 21, 2013, 5:23 PM), <https://bloom.bg/2BCbovF>.

88. Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 738 (2010); Jacoby & Janger, *supra* note 5, at 895.

89. *E.g.*, *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983).

90. Jacoby & Janger, *supra* note 5, at 888–89.

91. *See id.*

92. *See id.* at 865.

strong presumption in favor of distribution according to statutory priorities. Accordingly, steps should be taken to assure that there are sufficient funds retained to assure a distribution that is “fair and equitable.” This is a key lesson from *Jevic*. One mechanism for accomplishing this would be to use an “Ice Cube Bond,” setting aside a sufficient portion of the sale proceeds to assure that distributions will comply with the cramdown standard of § 1129(b). While *Jevic*’s holding does not apply to 363 sales, per se, its concern about end-runs applies equally.

In a recent working paper, Professor Douglas Baird has made a point somewhat similar to ours. He lauds RSAs but warns that they should be scrutinized for provisions that impede the flow of information to creditors and the court.⁹³ Our point is broader. We, too, are concerned about informational impediments, but our concerns extend to the impact RSAs can have on the voting process itself, as well as to the distributional scheme. Accordingly, we believe it is necessary not only to police the availability of information, but also to police distortions to the distributional scheme through procedural “end-runs.”

First, as noted, any provisions in an RSA that would deprive the signatories of the ability to change their vote if completion of the disclosure process revealed a material change or a better offer should be off limits. This view is rooted in *Jevic*’s concern about procedural end-runs.

Second, *Jevic* demonstrates the link between procedure (the plan confirmation process) and priority (the statutory waterfall). The link between procedure and priority is reflected in what we believe is a central norm of Chapter 11: no party may use procedural end-runs to leverage the common good of value maximization into an individual benefit from reordered priority. While the Code allows for bargaining against a backdrop of entitlements, it does not allow for coercion that overrides the plan process. For example, in the case of *DBSD North America, Inc.*, a creditor attempted to accumulate a blocking position to frustrate a plan in order to force the debtor to enter into a strategic transaction with it.⁹⁴ The Second Circuit upheld a designation of the creditor’s vote on the plan as not in good faith because the creditor was attempting to extract a personal benefit, rather than maximize the value of the estate or even benefit its class.⁹⁵

Accordingly, in our view, deviations from statutory priority are permissible only if:

93. Douglas G. Baird, *Bankruptcy’s Quiet Revolution*, U. OF CHI. COASE-SANDOR INST. FOR L. & ECON. RES. PAPER NO. 755 (Apr. 15, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2767057.

94. *Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79, 104 (2d Cir. 2010).

95. *Id.*

- (1) the distribution is on account of new value contributed post-petition that increases the overall value available for distribution without reducing the distribution of any particular creditor; or
- (2) when the procedural requirements of section 1129(a) are met.

This is the set of questions that judges must ask whenever they approve critical vendor motions under section 363, settlements under section 363 and Rule 9019, debtor-in-possession financing agreements under section 364, curing of defaults under contracts under section 365, and structured dismissals under *Jevic*. RSAs should be subject to the same sort of scrutiny.

CONCLUSION

When a company files for bankruptcy, it is in play. It can be purchased by its creditors, by its old owners (after exposure to the market or a non-exclusive plan process), or by a third party. In such circumstances, the plan confirmation process displaces the usual corporate governance machinery, and must do so, given the inadequacy of fiduciary duties where the residual claimant is uncertain. RSAs can be a useful tool in effectuating an orderly and value maximizing change of control.

RSAs, however, must remain just that, a tool for effectuating the plan process, rather than a substitute for it. Red flags arise when the RSA “locks in” a particular purchaser, or where the RSA does allow exit in the event of material change or a higher and better offer. Similarly, courts must be on guard for provisions that might chill a higher and better offer. Red flags also arise where the RSA seeks to “lock in” a particular distribution that deviates from statutory priority in a way that will bind non-signatories. Thus, RSAs should be scrutinized for such badges of opportunism to ensure that they are not being used as an end-run around the electoral majorities and substantive safeguards mandated by section 1129(a).

Where badges of opportunism are observed, the court has at its disposal a number of tools, depending on how the issue arises. If the debtor seeks to assume the RSA, or to enforce a milestone, then the court can condition its approval. If the debtor has not assumed the RSA, then separate classification, or designation of votes might be an appropriate remedy. Where a sale is contemplated prior to confirmation, an Ice Cube Bond can be used to facilitate completion of plan negotiations or compliance with the statutory priority waterfall. Just as RSAs are a flexible tool, courts should be alert, yet flexible, in how they are policed. But always they should be measured with an eye toward whether they facilitate or frustrate the plan process and whether they respect the Bankruptcy Code’s statutory distributional scheme.