Viewpoint

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A Novel Approach To Vote Solicitation On Prepackaged Plans

By James M. Millerman, Steven C. Krause and Arvin I. Abraham

The 2005 addition of section 1125(g) to the Bankruptcy Code has created the possibility of a novel but largely untested means of filing a prepackaged bankruptcy without a problem common to prepacks - providing hostile creditors advance notice of the Chapter 11 filing.

In a prepack, extensive negotiation between the debtor and its creditors takes place prepetition, thereby significantly decreasing the duration of the case, and thus avoiding some of the expense, business disruption and reputational harm of a traditional Chapter 11 filing. Typically, a prepack is intended to effectuate a financial rather than operational restructuring, wherein non-financial claims are paid in full. For the reasons discussed below, votes on a prepack traditionally have been solicited and received prepetition.

Section 1125(b) prohibits postpetition solicitation on a plan of reorganization prior to court approval of a disclosure statement. While section 1126(b) provides that votes cast prior to the commencement of a case are allowed, section 1125(b) had previously been held to require a would-be debtor to solicit and receive all votes on a prepack prepetition. As a result of this, and section 1125(c)'s requirement that each creditor receive a disclosure statement, prepacks have not been viable when a creditor might react adversely - for example, by initiating an involuntary proceeding or exercising remedies - due to the advance warning of a bankruptcy filing inherent in the solicitation.

In a 1997 report, the National Bankruptcy Review Commission recognized this problem and recommended that section 1125 be amended to allow prepack solicitation to be completed postpetition:

> Literally interpreted, [section 1125(b)] precludes the postpetition continuation or completion of the solicitation process begun prepetition in a prepack. This has two consequences. The debtor who has not yet completed every aspect of a prepack solicitation at the moment of filing a petition must forfeit many of the advantages of a prepack by returning to the much slower Chapter 11 track when the process may be almost complete. In addition, the 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.

Courts have also interpreted section 1125(b) to give little leeway to debtors seeking to solicit votes postpetition without a court-approved disclosure statement. Exemplifying this are a pair of Delaware bench rulings by Judge Mary Walrath issued in 2002: *In re Stations Holding, Inc.* and *In re NII Holdings, Inc.* In both rulings, certain votes on plan-support agreements received postpetition were "designated" (invalidated) by the court. The more illustrative is *NII Holdings*, in which the plan of reorganization had been negotiated and solicitation on plan-support agreements had commenced prepetition. However, some of the agreements were signed and/or dated a few days postpetition. The U.S. trustee argued that these votes were solicited in violation of section 1125(b). Walrath agreed, on the grounds that postpetition voting on a plan-support agreement constituted postpetition solicitation. The takeaway from these cases is that, absent section 1125(g), postpetition voting without a court-approved disclosure statement may violate section 1125(b).

However, section 1125(g) provides a safe-harbor from section 1125(b)'s limitation on postpetition solicitation. It provides that "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." Section 1125(g) has been interpreted as adopting the commission's recommendation that "[s]ection 1125(b) should be amended to provide that the acceptance or rejection of a plan may be solicited after the commencement of a case under title 11 but before the court approves a disclosure statement from those classes that were solicited for the plan prior to the filing of the bankruptcy petition." (Kurt Mayr, "Unlocking the Lockup: The Revival of Plan Support Agreements Under New § 1125(g) of the Bankruptcy Code," quoting the commission report.)

Section 1125(g) may also address the commission's concern that adverse creditors should not be able to derail a prepack. Theoretically, relying on section 1125(g),

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a potential debtor could commence solicitation on a proposed plan of reorganization and soon, or immediately, thereafter file its petition to prevent litigious holdout creditors from taking preemptive action. Applying this strategy, the voting period would "straddle" the petition date. Although votes would be received postpetition, they should not be designated if they were solicited prepetition in a manner complying with applicable non-bankruptcy law.

The Amended Procedural Guidelines for Prepackaged Chapter 11 Cases in the Southern District of New York Bankruptcy Court indicate that a straddle may be permissible. Section III.C. of the guidelines provides that:

> [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.

These guidelines indicate that, while a debtor may not continue to solicit votes postpetition, votes solicited prepetition will not automatically be designated if received after the petition date. However, 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. Guidelines with similar language have been adopted by bankruptcy courts in several other jurisdictions. In the only published decision citing section 1125(g) to allow continued post-petition voting, *In re CIT Group Inc.*, votes solicited prepetition were accepted after the petition date. CIT's counsel raised the issue of postpetition voting at the first day hearing and the confirmation order noted that the solicitation "was proper and in compliance with…section 1125(g)."

The novelty of a straddle does raise several unanswered questions:

- Could a court apply section 1126(b) to invalidate votes received postpetition?
- What, exactly, constitutes solicitation? A straddle depends on interpreting "solicitation" as transmission of solicitation packages or, more generally, the initiation of the solicitation process, rather than the completion of voting, however there is no judicial guidance yet.
- 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 after mailing solicitation packages, for example until receipt by creditors could be confirmed?

Clearly a straddle would be beneficial for a debtor caught between the need for an unheralded filing and the benefits of a prepack. Thus, while many issues remain unresolved, this strategy may eventually be employed, at which time courts may clarify the rules and procedures governing prepack solicitation and voting.

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