Post-Petition, Pre-Solicitation Plan-Support Covenants: Potential Tools for Mitigating a Free-Fall Filing

Date Created: Tue, 2022-06-07 12:17

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In bankruptcy, a debtor-in-possession's chief goal is to get its plan of reorganization confirmed by the bankruptcy court. [1] Among other things, the Bankruptcy Code requires that at least one class of impaired creditors vote to accept the plan — *i.e.*, that at least two-thirds in amount and one-half in number of the allowed claims in such class accept the plan. [2] Garnering the necessary creditor support for a plan is not always an easy undertaking, which has led to the modern trend of debtors filing pre-packaged or pre-arranged chapter 11 cases to ensure they have a clearer path to a confirmable plan. However, it is not always feasible to secure creditor support before filing for bankruptcy — especially for debtors who "free fall" into bankruptcy. Therefore, some debtors

who “free fall” into bankruptcy are using post-petition, pre-solicitation plan-support covenants to ensure that come plan-voting time, they will have — or be close to having — the necessary votes to confirm a plan.

In *In re Grupo Aeroméxico S.A.B. de C.V.*, [3] the debtors had no choice but to file a “free fall” case given the immediate, drastic effects of the COVID-19 pandemic on their businesses. However, during Aeroméxico’s chapter 11 cases (the “AMX cases”), the debtors were able to secure post-petition plan-support covenants with certain creditors to lock in material amounts of plan support early in the case. Importantly, even in the face of objection, the court found that such covenants were permitted.

As opposed to many other mega-chapter 11 cases where funded indebtedness providers (*i.e.*, financial institutions) hold the substantial majority of the outstanding claims, when an airline finds itself in bankruptcy a large segment of its claims are often held by aircraft lessors. Of Aeroméxico’s approximately $2.090 billion of pre-petition funded indebtedness, approximately $1.098 billion of it was related to aircraft-financing arrangements. [4] Of course, given that Aeroméxico is an airline, aircraft counterparties are an incredibly important constituency — and, critically, one that may be aligned with the debtors on ensuring a smooth plan-confirmation process, especially if those counterparties will be future commercial partners. Therefore, it made sense for the debtors to try and negotiate plan-support covenants in connection with claim settlements with those aircraft counterparties, since they were largely aligned with the debtors emerging as the most successful airline possible.

Throughout its restructuring, Aeroméxico undertook a robust, multi-step process to assume, reject and otherwise renegotiate agreements with its aircraft counterparties. As part of this process, Aeroméxico entered into a number of settlements and agreed-to assumption orders. Also as part of some of those agreements, counterparties agreed to support and vote in favor of Aeromexico’s plan as long as it was a “complying plan” (the “Plan Support Covenants”). [5] In many instances, the Plan Support Covenants also provided that if the counterparty sold its claim, the Plan Support Covenants traveled with the claim. [6] The Plan Support Covenants were part of many, but not all, of the orders approving aircraft contract assumptions and the order (the “Union Order”) approving Aeromexico’s entry into new collective bargaining agreements. [7]

While the use of the Plan Support Covenants to lock in plan support during the AMX cases was beneficial for the debtors, certain constituencies argued that it was not legally permissible. The AMX cases’ creditors’ committee objected to the use of the Plan Support Covenants because, among other things, they “effectively assign[] [a creditor’s] right to vote on a chapter 11 plan to the Debtors in contravention of section 1126(a) of the Bankruptcy Code.” [8] Notwithstanding, the court overruled the committee’s objection

because the Plan Support Covenants were part of negotiated settlements with counterparties represented by sophisticated counsel, the terms of the settlements were "out in the open" and on the docket, counterparties were not required to accept the Plan Support Covenants, the Plan Support Covenants were previously and widely used in Aeroméxico's and Philippine Air's chapter 11 cases, and the court felt they were "value accretive ... towards the cause of streamlining the plan process." [9]

The committee was not the only party that took issue with the Plan Support Covenants. A subsequent purchaser of certain claims also opposed the use and application of the Plan Support Covenants vis-à-vis their claims, which were claims (the "Union Claims") originally granted to and owned by the debtors' unions. As described in the Union Order, the Union Claims were subject to Plan Support Covenants that traveled to subsequent purchasers of the Union Claims. Therefore, the subsequent purchaser was obligated to support and vote in favor of the debtors' plan as long as it was a complying plan. Notwithstanding, the subsequent purchaser voted against the debtors' plan. The debtors sought to have the subsequent purchaser's votes deemed "voted in favor of the Plan" in accordance with the Plan Support Covenant (the "Support Motion"), [10] and the subsequent purchaser objected to such relief. [11] Among other things, the subsequent purchaser argued that the Plan Support Covenants violated § 1125(b) of the Bankruptcy Code. [12] The court did not agree with the subsequent purchaser and ruled in the debtors' favor on the Support Motion. The subsequent purchaser appealed that decision. [13] Ultimately, however, the appeal was withdrawn on the eve of confirmation, when a settlement was reached between the subsequent purchaser and the debtors. Therefore, the legitimacy of the subsequent purchaser's arguments may live to see another day.

In sum, as Aeroméxico's recent chapter 11 cases illustrate, utilizing plan support covenants post-petition and pre-solicitation may be a helpful tool for debtors to use to lock in plan support early in the case to streamline the plan-confirmation process. However, as highlighted above, this approach is not without its risks. While Judge Chapman approved the Plan Support Covenants in Aeroméxico, their permissibility was appealed and ultimately the issues settled. Therefore, not all of the arguments against the use of plan support covenants have been laid to rest. Further, the use of plan support covenants is still a live issue in LATAM Airline's chapter 11 cases. [14] Therefore, while the Plan Support Covenants proved to be a successful and value-maximizing tool in the AMX cases, their use is not without bounds or risks.

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[2] 11 U.S.C. § 1126.

[3] No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020).

[4] *See Disclosure Statement for the Joint Chapter 11 Plan of Reorganization of Grupo Aeroméxico, S.A.B. de C.V. and Its Affiliated Debtors* [ECF No. 2294], at 25-31, No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020).

[5] *See, e.g., Order Approving the Claims Settlement Among Debtor Aerovías de Mexico, S.A. de C.V., Jet Leasing, and Certain Parties* [ECF No. 1936], at 4, No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020) ("A chapter 11 plan shall be deemed a 'Complying Plan' if it treats the Allowed Claims (a) as allowed general unsecured non-priority claims not subject to reconsideration under section 502 of the Bankruptcy Code and (b) no worse than the non-priority unsecured claims of any other aircraft or engine lessor whose claims run solely against the Debtor Lessee (other than *de minimis* 'convenience class' claims).").

[6] *See, e.g., id.*

[7] *See Order Pursuant to 11 U.S.C. §§ 363(b), 105(a) and Fed. R. Bankr. P. 9019(a) Authorizing Entry Into New Agreements Establishing New Labor Conditions with ASPA, ASSA, STIA and Independencia* [ECF No. 1101], No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020).

[8] *See Limited Objection of the Official Committee of Unsecured Creditors to Certain Terms of Claims Settlement Motions* [ECF No 2107], at 3-4, No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020). In addition to the arguments formally laid out in the committee's objection and the subsequent purchaser's (as defined below) objections and responses, parties adverse to the debtors may also try to argue that the debtors acted in bad faith when securing post-petition, pre-solicitation plan-support covenants, and therefore, that the locked-up votes should be designated or disqualified. *See* 11 U.S.C. § 1126(e).

[9] *See In re Grupo Aeroméxico S.A.B. de C.V.*, No. 20-11563 (SCC) (Bankr. S.D.N.Y.), Nov. 16, 2021 Hr'g Tr. at 39, 41, 43, 51; *see also Debtors' Reply to Limited Objection of the Official Committee of Unsecured Creditors to Certain Motions* [ECF No. 2110], at 3, No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020) (by the time the court was considering the Committee's objection, the court had already entered orders approving the use of the Plan Support Covenants for almost $750 million worth of claims).

[10] *Debtors' Motion to Enforce the Court's Order Authorizing Entry Into New Agreements Establishing New Labor Conditions with ASPA, ASSA, STIA, and Independencia* [ECF No. 2356], at 6, No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020).

[11] *See Invictus Global Management, LLC's Response to Debtors' Motion to Enforce the Court's Order Authorizing Entry Into New Agreements Establishing New Labor Conditions with ASPA, ASSA, STIA, and Independencia* [ECF No. 2391], No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020) ("Subsequent Purchaser Response").

[12] *See* Subsequent Purchaser Response at 18.

[13] *See Designation of Record and Statement of Issues Submitted by Appellant Invictus Global Management LLC Pursuant to Federal Rule of Bankruptcy Procedure 8009* [ECF No. 2578], No. 20-11563 (SCC) (Bankr. S.D.N.Y. 2020).

[14] In LATAM Airline's chapter 11 cases, certain parties, including the creditors' committee, objected to the approval of the debtors' disclosure statement and confirmation because, among other things, the debtors allegedly violated § 1125(b) of the Bankruptcy Code when "seeking and obtaining agreements from unsecured creditors to vote in favor of the Plan in exchange for the Debtors' stipulating to the allowance of their claims." *Supplement to the Objection of the Official Committee of Unsecured Creditors to the Debtors' Motion to Approve (I) The Adequacy of Information In the Disclosure Statement, (II) Solicitation and Voting Procedures, (III) Forms of Ballots, Notices and Notice Procedures in Connection Therewith, and (IV) Certain Dates with Respect Thereto* [ECF No. 4171], No. 20-11254 (JLG) (Bankr. S.D.N.Y. 2020); *see also Objection of the Official Committee of Unsecured Creditors to Confirmation of the Debtors' Sixth Revised Joint Plan of Reorganization of LATAM Airlines Group S.A., et al. Under Chapter 11 of the Bankruptcy Code* [ECF No. 5195], No. 20-11254 (JLG) (Bankr. S.D.N.Y. 2020). As of the date of writing this article, the LATAM court has not ruled upon this issue.

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