Bankruptcy and Restructuring Litigation Update

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Court Refuses to Approve Debtors' Decision to Assume Plan Support Agreement: On December 20, 2010, the Bankruptcy Court for the Southern District of New York refused to approve a debtors' request to assume a prepetition plan support agreement ("PSA") that provided for the issuance of 100 percent of the reorganized debtors' equity to one of the debtors' prepetition secured lenders. Notably, the lender had cut a side deal with the debtors' prepetition equity holder to sell half the equity received under the PSA. Although the court noted that the entire fairness standard was likely applicable, it applied the less stringent business judgment standard in refusing to approve the PSA. It also refused to find that the debtors' decision was disinterested. The debtors had always intended to transfer equity to its former owner whether directly, as a back-stop party, or through the side deal with a secured creditor. Similarly, the court found that the PSA was not entered into with due care because the debtors did not "shop" the deal to potential alternative counterparties. Finally, the court refused to find the debtors had acted in good faith. It noted that "virtually all of the other parties in interest in the debtors' capital structure" complained they had been shut out of the process. It additionally ruled that the fact that the debtors' equity holder would retain 50 percent of the reorganized equity was "at best, downplayed and, at worst, obfuscated" from such parties. Finally, the court viewed as excessive the control over cash collateral afforded to the secured creditor under the PSA, including a prohibition imposed on the debtors precluding them from seeking competitive proposals, reimbursement of the secured lender's costs, and, in certain instances, a requirement that the debtors consent to lifting the stay. The case is *In re Innkeepers USA Trust, et al.*, No. 10-13800 (SCC) (Bankr. S.D.N.Y. Jul. 19, 2010), and is important precedent examining the limitations of prepetition plan arrangements among debtors and stakeholders.

Second-Lien Lenders Find Way Around Prohibition on Objecting to Sale: On September 30, 2010, the Bankruptcy Court for the District of Delaware allowed second-lien lenders to object to the debtor's sale "process," notwithstanding provisions in their inter-creditor agreement with the first-lien lenders purportedly waiving their right to object to or oppose a section 363 sale if the first-lien lenders consented to the sale. The debtor sought to sell its businesses to their first-lien lenders, who submitted a credit bid. Drawing a distinction between the sale transaction itself and the process leading to it, the court allowed the second-lien lenders to argue that the debtor inappropriately ignored the competing bid of Energizer Holdings, Inc., which was valued at $56 million more than the first-lien lenders' bid. The second-lien lenders also protested the debtor's refusal to allow for additional due diligence and challenged as unreasonable the determination that Energizer was not a qualified bidder. The second-lien lenders contended that the debtor exaggerated purported antitrust concerns implicated by the Energizer bid. The court viewed all those complaints as related to the sale "process" and not the putative sale transaction itself. It concluded that such distinction brought the second-lien lenders' objection outside the contractual restrictions in the inter-creditor agreement. Ultimately, the court refused to approve the sale to the first-lien lenders and allowed Energizer to resume due diligence. Shortly thereafter, Energizer consummated a transaction. The case is *In re American Safety Razor, LLC, et al.*, No. 10-12351 (MFW) (Bankr. D. Del.), and may prove useful to contractually-subordinated creditors.

Creditors of Solvent Debtors Entitled to "Make Whole" Claim: On September 3, 2010, the Bankruptcy Court for the Southern District of Mississippi held that the solvent debtors' repayment of notes breached the indenture's "no call" provision prohibiting any refinancing or repayment of the notes for a four-year period following issuance. The indenture further provided for a prepayment premium if the debtors caused an event of default with the intent to avoid the no-call provision. The proceeds of the notes were used to finance the construction of a casino. After Hurricane Katrina destroyed the casino, the debtors filed for bankruptcy to access insurance proceeds. They then sought to repay the notes in full with interest under a plan. The court found that under the indenture, the noteholders were not entitled to the prepayment the debtors were solvent. In such instance, the court reasoned, it would be inequitable to excuse the debtors from their contractual obligations. The case is *Premier Entm't Biloxi LLC v. U.S. Bank Nat'l Ass'n*, 2010 Bankr. LEXIS 2994 (Bankr. S.D. Miss. Sept. 3, 2010).