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RESTRUCTURING SUPPORT AGREEMENTS: AN IN-COURT SOLUTION WITH OUT-OF-COURT BENEFITS

Restructuring Support Agreements ("RSAs") are pre- or post-petition agreements among key constituents that require their signatories to support a chapter 11 plan with certain agreed-to terms. The authors give an overview of such agreements, a historical perspective vis-à-vis the Chandler Act, and the benefits and criticisms regarding such agreements. They conclude that RSAs provide debtors with the typical benefits of chapter 11 while reducing the time and expense of traditional chapter 11 cases.

By Felicia Gerber Perlman and Natalie Rowles *

Companies confronting financial challenges often find themselves faced with a host of important decisions to make in evaluating strategies to best protect value and ongoing operations. Frequently, chief among these decisions is whether a chapter 11 bankruptcy filing or other form of restructuring would be advantageous for the company. While bankruptcy can confer substantial benefits upon distressed companies, such as an automatic stay that prevents creditors from pursuing claims against the company, an opportunity to shed burdensome contracts and leases, and an ability to sell assets free and clear of liens, claims, and other encumbrances, it can also come with significant costs and challenges. These include increased professional fees, an enlarged restructuring time frame, and a significant interruption to business operations. Boards often struggle to balance these benefits and costs in determining whether an in-court or out-of-court restructuring is more beneficial.

In addition to these two paths, a third path (or at least a variation of the path to a chapter 11 filing) may provide an opportunity to obtain some of the benefits of a chapter 11 filing without all the attendant costs. This increasingly popular third option is the "prearranged" or "prenegotiated" bankruptcy case, through which debtors engage in substantial negotiations with certain key stakeholders prior to a bankruptcy filing in order to reach an agreement on the restructuring of those stakeholders' claims ahead of the chapter 11 filing.[1] The agreed-to terms are documented in what's known as a restructuring support agreement, or "RSA."

This article provides an overview of RSAs as a means of securing the benefits afforded to chapter 11 debtors under the Bankruptcy Code while reducing the time and costs associated with traditional chapter 11 cases. The article also explores some of the concerns related to RSAs that have come to the fore in recent years, as well as the limitations of those concerns.

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[1] "Prepackaged" bankruptcies, or "prepacks," go a step further than cases that are merely prenegotiated. In prepacks, debtors complete solicitation and obtain the requisite votes for approval of a plan prior to the chapter 11 filing.

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RSA OVERVIEW

RSAs, which sometimes are referred to as "Plan Support Agreements" or "PSAs,"[2] are the means by which prenegotiated agreements regarding a bankruptcy filing are documented. At their core, RSAs are pre- or post-petition contracts between certain key constituents that require signatories to agree to support a plan that contains certain agreed-to terms. RSAs are also known as "lock-up agreements"[3] in light of the binding effect they have on their signatories.

In recent years, preplanning has become a linchpin of successful chapter 11 restructurings. Unsurprisingly, "[p]lanning helps," and a debtor's ability to "pre-vet" a proposed plan for exiting bankruptcy with key constituents increases the likelihood of successful outcomes and a debtor's ability to confirm a chapter 11 plan.[4] Accordingly, while not new or novel, prepackaged or otherwise prenegotiated bankruptcy filings have accounted for a greater percentage of filings over the past decade, and all signs point toward a continued increase, especially for reorganizations of larger companies.[5] Thus, RSAs have taken on an increasingly important role in the chapter 11 context and the ultimate success of chapter 11 filings.

The structure of an RSA will vary from case to case, but certain provisions have become standard. The cornerstone of an RSA is the agreement to support the plan contemplated therein. Creditors may also agree not to impede plan confirmation and not to transfer or assign claims that are the subject of the RSA. RSAs might include entire classes of creditors or just a few key constituents, and the agreement may be solely among creditor constituencies or may include the debtor as a party. RSAs typically include a term sheet that describes the contemplated restructuring, as well as milestones for various in-court and out-of-court events. In-court milestones may relate, for example, to the filing of a petition, plan, or sale motion or confirmation of a plan, and out-of-court milestones may relate to dates for debt exchanges, votes, and solicitation, among other things.

Another important provision included in most RSAs that is beneficial for debtors is a "fiduciary out," which allows the debtor to terminate the RSA if the debtor, exercising its business judgment, determines that remaining in the agreement would no longer be in the best interests of the estate (for example, if the debtor were to receive what it might perceive as a superior restructuring offer after entering into the RSA).[6]

[2] These agreements are typically referred to as RSAs when negotiated before a bankruptcy filing and PSAs when negotiated after a filing. David A. Skeel, Jr., *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366, 370 n.7 (2020), https://www.yalelawjournal.org/article/distorted-choice-in-corporate-bankruptcy.

[3] *See, e.g.*, Notice of Filing of Restructuring and Lock-Up Agreement, *In re Caraustar Industries, Inc.*, No. 09-73830 (MGD), Docket No. 714 (Bankr. N.D. Ga. June 30, 2009).

[4] Edward J. Janger & Adam J. Levitin, *Badges of Opportunism: Principles for Policing Restructuring Support Agreements*, 13 BROOK. J. CORP., FIN. & COM. L. 169, 174 and 174 n.26 (2018) (comparing the relative success of Chrysler's bankruptcy case, where the debtor entered bankruptcy with a "clear idea of how it planned to emerge," with the obstacles encountered by Lehman Brothers in its bankruptcy case after it "stumbled into bankruptcy when the Federal Reserve Bank declined to bail it out.").

[5] *See, e.g.*, John Yozzo & Samuel Star, *For Better or Worse, Prepackaged and PreNegotiated Filings Now Account for Most Reorganizations*, ABI J. 18 (Nov. 2018) (demonstrating that prepackaged, prenegotiated, or prearranged bankruptcy filings

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accounted for a majority of cases that emerged from chapter 11 via a confirmed reorganization plan between 2015 and 2018). Courts, likewise, seem to be responding with approval to the increase in some sort of preplanning in the chapter 11 context and looking for ways to support a streamlined chapter 11 process. For example, the U.S. Bankruptcy Court for the District of Delaware recently amended its local rules so as to broaden the scope of circumstances in which debtors can seek combined hearings for disclosure statement approval and plan confirmation. Combined hearings were previously permitted only for liquidating plans with less than $25 million in assets being distributed, but that limitation has been eliminated under the revised version of the rules. *See* Del. Bankr. L.R. 3017-2.

[6] While fiduciary outs may provide a debtor with some comfort if it decides to terminate an RSA, the fact that a chapter 11 plan cannot be confirmed unless it meets the requirements set forth in

Fiduciary outs may take a relatively lenient form that allows a debtor to terminate the RSA if the board determines that the exercise of its fiduciary duties requires it to do so, or they may take a more stringent form that requires the board to obtain a written opinion of counsel supporting its position that a change of circumstances requires it to back out of the RSA. Fiduciary outs may also require debtors to provide prior notice to creditors before terminating an RSA.[7]

In addition to the benefits RSAs provide to debtors, RSAs may also provide benefits to creditor signatories. Increased certainty regarding payment terms, liability releases, or a right to provide debtor in possession financing are among the various provisions a creditor might ask to be included in an RSA in exchange for its support of the proposed plan. The provision of these benefits, however, is still subject to approval of the bankruptcy court. In addition, many RSAs include a "signing fee" provision contemplating payment to signing creditors. These provisions aim to compensate creditors for any professional fees they might incur in the course of negotiating the RSA.

It is important to note that RSAs are not a restructuring panacea and can only address issues related to a company's capital structure. They do not give a debtor the ability to reject executory contracts or unexpired leases, which is a right reserved for debtors in bankruptcy.[8] While an RSA might provide that a debtor will seek to reject a contract or lease, or that an impaired creditor class will be created, such provisions are subject to the requirements of the Bankruptcy Code, including notice to the affected parties and bankruptcy court approval. RSAs also do not allow a debtor to address its potential litigation liability. Thus, while distressed companies and their stakeholders can easily become enamored by the speed and cost reductions associated with RSAs, they should keep these limitations in mind so as not to be lulled into signing onto an agreement that ultimately will not give them what they need.

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Bankruptcy Code section 1129 may also require debtors to walk away from RSAs that contemplate unconfirmable plans in light of changed circumstances.

[7] *See, e.g.*, Morris J. Massel, *How to Negotiate a Ch. 11 Plan Support Agreement*, LAW360, Oct. 16, 2013, https://www.law360.com/articles/480786/how-to-negotiate-a-ch-11-plan-support-agreement.

[8] 11 U.S.C. § 365.

HISTORICAL PERSPECTIVE

Before delving into the benefits and drawbacks of RSAs, a brief summary of the historical backdrop against which modern day RSAs are often viewed will likely prove helpful in understanding the concerns related to RSAs. In 1938, the Chandler Act amended the section of the Bankruptcy Act of 1898 — the predecessor to the Bankruptcy Code — dealing with corporate reorganizations. The genesis of the Chandler Act consisted of, among other things, the following:

> The SEC believed: that abuses in the reorganization system had been widespread; that individual securityholders had not been able to protect themselves; that if they desired to work out a reorganization, lists of their fellow securityholders would not have been readily available, and therefore they had been at the mercy of the inside groups — the management and the investment bankers — who frequently had objectives incompatible with those of investors, the inside groups being interested among other things in concealing claims for fraud or mismanagement, whereas the investors were interested in collecting on such claims; that inside groups were also interested in reorganization profits, whereas the investors were interested in economy and fairness; and that the inside groups were interested in "face saving" which produced unsound reorganizations, whereas investors were interested in thorough going reorganizations.[9]

In other words, the Chandler Act was born out of concerns about preconceived plans negotiated between management and key lenders, and the fact that smaller stakeholders — whose interests might not have aligned with those of management and key lenders — were often at the "mercy" of such "inside groups."

While the Chandler Act's solutions to such issues included the appointment of a disinterested trustee in all large corporate reorganizations — an approach that is fundamentally at odds with the idea of a "debtor in possession" in chapter 11 — some have argued that the concerns that gave rise to the Chandler Act bear some resemblance to the forces at play in modern-day RSAs.[10]

[9] Alfred N. Heuston, *Corporate Reorganizations Under the Chandler Act*, 38 COLUM. L. REV. 1199, 1203 (1938).

[10] *See, e.g.*, Edward J. Janger & Adam J. Levitin, *The Proceduralist Inversion – A Response to Skeel,* 130 YALE L.J.

These criticisms fail to appreciate, however, the protections provided by the Bankruptcy Code's confirmation requirements as well as the considerable benefits that shorter, more efficient chapter 11 cases provide to all creditors.

RSA BENEFITS AND DRAWBACKS

Capital structures have become more complex since the enactment of the Chandler Act. This increased complexity can result in difficulties negotiating a restructuring with multiple creditors and creditor groups. Given these difficulties, as well as the increase in the cost of chapter 11 cases and the resulting need for a more efficient chapter 11 process,[11] it is no surprise that RSAs, with their ability to incorporate the basic terms of a plan quickly and efficiently, have become an increasingly favored means of brokering agreements among debtors and their stakeholders. RSAs, which can be negotiated pre-filing, post-filing, or both, allow a debtor to bargain "in the shadow of liquidation or cramdown,"[12] with the idea being that what lurks in such shadow would be a far worse eventuality for all parties involved than an agreed-to restructuring arrangement. Thus, there is a strong incentive for parties to build consensus and come to an agreement that may not be present in the out-of-court context.

In addition, the explosion of distressed debt investing and claims trading in bankruptcy has created an environment in which it is possible for distressed debt investors to acquire a blocking position and veto a debtor's proposed plan.[13] The ability to bind creditors and prohibit claims trading through the use of RSAs renders them an attractive option to help provide a measure of certainty to a process that might otherwise be upended by disparate and volatile interests. Given the added protections for creditors built into the Bankruptcy Code's plan confirmation requirements — including that (1) each holder of a claim or interest in an impaired class of claims or interests either must have accepted the plan or will receive an amount not less than the amount such holder would receive if the debtor were liquidated under chapter 7; (2) each class must have either accepted the plan or not be impaired under the plan (subject to the cramdown provisions); and (3) in order for a class to have accepted a plan, it must be approved by creditors or interest holders that hold at least two-thirds in dollar amount and more than one-half in number of the allowed claims or interests in the class who actually vote — RSAs bestow benefits on all parties in interest without implicating the same concerns regarding creditors being placed at the mercy of inside groups that were present at the time of the Chandler Act's enactment.

While the benefits of RSAs are indisputable, certain criticisms of RSAs have garnered attention in recent years. One of the main critiques of RSAs relates to disenfranchisement. Critics argue that because a debtor's largest creditors have the most leverage, and because it would be impractical to negotiate prepetition RSAs with diffuse trade creditors, most negotiation participants tend to be large financial creditors. Therefore, according to critics, RSAs place the most sophisticated and well-funded stakeholders in an even better position, often at the expense of smaller trade and other creditors who do not have the means or leverage to have a voice at the RSA negotiation table. Moreover, once an RSA is supported by large key constituencies, critics contend, the costs of opposing the envisioned plan are often prohibitive for other creditors, rendering the "proposal" a "*fait accompli*" that smaller creditors have no choice but to accept.[14] Thus, the argument goes, the RSA process undercuts the right of creditors under the Bankruptcy Code to accept or reject a plan[15] and harkens back to the preconceived plans that precipitated the Chandler Act.

The phenomenon of larger creditors possessing more leverage, however, is not unique to the RSA context. In fact, larger creditors, who often have the most to lose in distressed situations, almost always command more attention than creditors with less at stake, regardless of whether a chapter 11 case is prenegotiated and regardless of whether there is a chapter 11 case at all. Thus, any disenfranchisement associated with the RSA process is not likely attributable to the RSA itself, but

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F. 335, 339 (2020) ("The Chandler Act embodied the 'traditionalist' approach to bankruptcy, which was deeply suspicious of these RSA-type coordination devices precisely because they were understood to lock-in abuses of the restructuring process by senior creditors and incumbent management.").

[11] Lenders are not shy to use their leverage to exert pressure on debtors to get through chapter 11 as quickly as possible.

[12] Janger & Levitin, *supra* note 4, at 177.

[13] Skeel, *supra* note 2, at 366 (citing Frederick Tung, *Confirmation and Claims Trading*, 90 NW. U. L. REV. 1684 (1996)).

[14] Janger & Levitin, *supra* note 4, at 173.

[15] 11 U.S.C. § 1126(a) ("The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan.").

rather to the economic realities of modern-day capital structures.

Further, the Bankruptcy Code incorporates several protections for smaller holders of debt from disenfranchisement. As previously noted, the Bankruptcy Code embodies a numerosity requirement for a class's acceptance of a plan. In addition, while it is often the case that trade and other smaller creditors are not impaired in prearranged cases, if such creditors are impaired, they have the right to vote to reject the plan. These safeguards protect smaller creditors from potential disenfranchisement.

Another criticism of RSAs relates to whether the RSA process may, in certain circumstances, constitute an end run around the Bankruptcy Code's carefully crafted disclosure and solicitation provisions. Under the Bankruptcy Code, solicitation of an acceptance or rejection of a plan is prohibited unless a plan or summary of the plan and a "written disclosure statement approved . . . by the court as containing adequate information" is first transmitted to the holders of claims and interests.[16] As no court-approved disclosure statement is distributed to signatories to RSAs prior to their agreeing to vote in favor of a certain plan, the argument is that the RSA process may constitute impermissible solicitation.

Bankruptcy Courts, however, by and large have not found impermissible solicitation in the RSA context. In fact, while the U.S. Bankruptcy Court for the District of Delaware, in a couple of prepack cases from the early 2000s, took issue with certain postpetition RSAs and designated (or disqualified) the votes of the signing creditors,[17] courts have regularly approved RSAs since that time.

A case that is often cited in support of the proposition that RSAs do not constitute impermissible solicitation is *In re Indianapolis Downs, LLC*.[18] There, the U.S. Bankruptcy Court for the District of Delaware narrowly construed the definition of "solicitation" as excluding negotiations related to RSAs and refused to designate the votes of the RSA's signatories under Bankruptcy Code section 1125(g) and 1126(e). The Court adopted the analysis and reasoning in *In re Heritage Organization, L.L.C.*, in which the U.S. Bankruptcy Court for the Northern District of Texas found that "if a creditor believes that it has sufficient information about the case and the available alternatives to jointly propose a Chapter 11 plan with another entity (whether that co-proponent is another creditor, the debtor, or a trustee (who also believes that it has sufficient information)), it is absurd to think that the signing of a term sheet by those parties (that contains the material terms of their to-be-filed joint plan and states that the co-proponent creditor(s) will vote for their agreed upon joint plan) is an improper solicitation of votes in accordance with § 1125(b)."[19] The Court in *Indianapolis Downs* added that "the filing of a Chapter 11 petition is an invitation to negotiate" and that "[w]hen a deal is negotiated in good faith between a debtor and sophisticated parties, and that arrangement is memorialized in a written commitment and promptly disclosed, § 1126 will not automatically require designation of the votes of the participants."[20] Thus, the Court concluded, disqualification was not appropriate.

CONCLUSION

While there is no shortage of opinions from judges, practitioners, and scholars on how and whether RSAs should be regulated, most have not questioned their utility and the import of what they bring to the table. With their unique ability to provide debtors with the typical benefits of chapter 11 while simultaneously reducing the time and costs associated with traditional chapter 11 cases, RSAs arguably deliver their signatories the best of both the chapter 11 and out-of-court restructuring worlds. Further, RSAs benefit creditors, as the reduced costs increase recoveries and promote judicial efficiency, all within the bounds of the creditor protections enshrined in the Bankruptcy Code. It is no wonder, therefore, that the trend seems to be toward a growing percentage of prepackaged or otherwise prenegotiated cases. While this trend is still relatively recent, the clear advantages of a debtor's ability to bind key stakeholders before making its foray into chapter 11 suggest that this growth will continue. ■

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[16] 11 U.S.C. § 1125(b).

[17] *In re Stations Holdings Company, Inc.*, No. 02-10882 (MFW) (Bankr. D. Del. Sept. 30, 2002) [Doc. No. 177]; *In re NII Holdings, Inc.*, No. 02-11505 (MFW) (Bankr. D. Del. Oct. 22, 2002) [Doc. No. 367].

[18] 486 B.R. 286 (Bankr. D. Del. 2013).

[19] *Id.* at 293–94 (quoting *In re Heritage Organization, L.L.C.*, 376 B.R. 783, 791 (Bankr. N.D. Tex. 2007)).

[20] *Id.* at 297.