Ethical Issues in Bankruptcy: RSAs, DIP Financings, and Common Interest Privilege Issues

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Hon. Stacey G. C. Jernigan, U.S. Bankruptcy Court, Northern District of Texas - Dallas, TX
Hon. Chris López, U.S. Bankruptcy Court, Southern District of Texas - Houston, TX
Deborah M. Perry, Munsch Hardt Kopf & Harr, P.C. - Dallas, TX
Jennifer Wertz, Jackson Walker LLP - Austin, TX

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Restructuring Support Agreements

- A restructuring support agreement (RSA), also called a "plan support agreement" or "lock-up agreement" in various contexts, is a contract entered into between (i) a debtor and (ii) some combination of key creditors, equity holders, and stakeholders wherein the parties agree to support a proposed case strategy and plan structure, subject to specific terms and conditions agreed to in the RSA.
- RSAs are most commonly entered into prepetition to coalesce support around a pre-negotiated plan prior to seeking bankruptcy court approval of a disclosure statement and authority to solicit votes on the plan.
- RSAs can benefit a debtor and its stakeholders by making the chapter 11 process more efficient, predictable, and cost-effective while also signaling to the market and investors that the debtor has a feasible path forward in its reorganization.

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Restructuring Support Agreements

- RSAs typically include some form of the following provisions agreed to among the parties:
  - Consent Rights for Definitive Documentation
  - Case Milestones
  - Support Commitments (voting for and not objecting to the Plan)
  - Forbearance from contractual termination rights outside the RSA
  - Provisions for the holding and selling of claims or interests
  - Representations and Warranties
  - Releases for parties to the RSA
  - Fees and expenses incurred by professionals of the various parties
  - Termination Events (e.g., breaking commitments, missing milestones, supporting alternative transactions)
    - Fiduciary Outs (Debtors and Creditors)
  - Remedies for a breach and the effect of termination of the RSA
  - Amendment process for the RSA
  - Governing law and jurisdiction provisions
  - Reservations of rights
  - Disclosure to the public or to parties not signing the RSA

Ethical Considerations for RSAs

- RSAs have been accused of subverting the traditional chapter 11 process and the safeguards built into the Bankruptcy Code intended to protect all parties, including the debtor, in negotiating a certain case strategy and prosecuting a plan. Some have argued that RSAs can be construed as an improper solicitation of votes or an impermissible *sub rosa* plan.
- RSAs may lock-up parties (including the debtor) before all relevant information is disclosed during a bankruptcy case.
- Both creditors and debtors are at risk of bargaining away too much too soon to get an RSA signed on an expedited negotiation timeline.
- A debtor may functionally give away its exclusivity period by agreeing to Plan terms before the case commences and the bankruptcy court and the U.S. Trustee have oversight in the process.
- Many of the ethical considerations (for both substance and optics) hinge on a debtor's good-faith effort to build consensus among its key constituencies while preserving optionality to exercise its fiduciary duties and pursue other value-maximizing transactions that may arise and provide a greater benefit to a debtor's estate.

RSAs: Case Study on Process

- When RSAs are scrutinized, two of the key issues are often: (1) whether there was a good-faith process to lock up support for transactions that maximize value for the estate, and (2) which parties were included/excluded in that process.
- For example, in *In re Innkeepers USA Trust*, 442 B.R. 227 (Bankr. S.D.N.Y. 2010), a motion to assume a prepetition RSA was denied where:
  - (i) the Debtors' largest secured creditor was the only creditor party to the RSA (locking up just $238M of the total $1.4B in secured debt);
  - (ii) secured creditor was to be issued 100% of the new shares of common stock of the Reorganized Debtors (despite not having a lien on collateral of the majority of the debtor entities) and subsequently sell 50% of such shares to the Debtors' ultimate parent company; and
  - (iii) all other secured creditors were to receive new secured notes with values to be assigned in the plan.

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RSAs: Case Study on Process

- The court held that, under either the business judgment or entire fairness standard, the Debtors did not meet their burden because, among other reasons:
  - The proposed transactions were not disinterested where the Debtors' equity parent was ultimately going to receive substantial new equity from the secured creditor.
  - The Debtors did not exercise their fiduciary duty to run any type of market process or explore any alternatives to maximize value for their estates.
  - The Debtors were severely limited from exploring alternatives by a flawed "fiduciary out" provision which (i) prohibited the Debtors from taking actions consistent with their fiduciary obligations and (ii) required that, in order to modify any milestone, the Debtors must be pursuing an alternative transaction that would provide the RSA creditor with a higher and better recovery.
  - The process was not in good faith where prejudicial to the vast majority of secured creditors who received little disclosure or involvement in exchange for the benefit of locking up a single creditor without sufficient support to confirm a plan.

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Title search: Ethical Issues in Bankruptcy: RSAs, Prepetition Prepayment of Employee Incentive, Common Interest Privilege Issues

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