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Motive Counts When Voting on a Plan

by: Harold S. Berzow
Ruskin Moscou Faltischek PC, Uniondale, N.Y.

Hon. **Robert E. Gerber** recently issued two decisions related to voting on the debtor's plan in *In re DBSD North America Inc.*, case number 09-13061 (REG) in the U.S. Bankruptcy Court for the Southern District of New York that have broader implications for plan confirmation in bankruptcy cases. The first decision[1] dealt with the debtor's motion to designate DISH Network's vote to reject its plan. DISH became the sole holder of senior debt in a class of secured creditors by purchasing, at par, all the claims with the stated purpose of acquiring control of the asset that collateralized the debt. It also purchased second-lien debt only from sellers who were not bound by an agreement to support the debtor's plan. DISH recognized that it was overpaying for the debt, but was willing to make the investment because it had an interest in the underlying assets and wanted a relationship with an affiliated entity of the debtor.

The court designated DISH's vote under §1126(e) as being made in bad faith. It found that DISH did not act as a traditional creditor, but rather as a strategic investor seeking to establish control over the entity. In support of its ruling, the court reasoned that DISH sought to advance interests apart from recovery under the plan by buying the claims at par and had expressed a strategic purpose of taking over an affiliated entity of the debtor. According to the bankruptcy court, DISH's acquisition of the first-lien debt was not to make a profit, but rather to become a strategic investor, obtain a blocking position, control the bankruptcy process and enable DISH to convert debt to equity and acquire control of the debtor's affiliated entity.

Judge Gerber followed up his first decision with a written, unreported bench decision[2] confirming the debtor's plan and dealing with the consequences of the bankruptcy court's earlier decision. Because DISH had bought all of the claims in Class 1, the court's first decision created what Judge Gerber called an "uncommon follow-up issue": Since DISH's vote was disqualified, there was no creditor left in that class to vote on the plan. The courts then focused on whether this meant that the debtor could not satisfy §1129(a)(8), because the class comprising the DISH claims had not voted in favor of the plan, possibly requiring the court to "cram down" the plan, as provided in §1129(b). Judge Gerber found this to be an issue of first impression and concluded that the class of which DISH was a part is not counted as a negative vote, because the provisions of §1129(a)(3) providing for safeguards of good faith "ensure that plan proponents don't abuse the benefits of a court's designation ruling." This application of §1129(a)(3) appears unusual, because the plan under consideration was proposed by the debtor and not DISH. The bankruptcy court effectively placed the statutory good-faith safeguard on a nonproponent of the plan to find that a negative vote was to be considered an accepting vote and that cramdown was unnecessary.

In support of its decision, the bankruptcy court's opinion cited *In re Ruti-Sweetwater*, 836 F. 2d 1263 (10th Cir. 1988), in which the Tenth Circuit was faced with a creditor-appellant that had neither objected to, nor voted on, the plan. The creditor raised its first objection when sale proceeds from property on which he had a lien were to be distributed. The bankruptcy court approved the sale of the debtor's property free and clear of the creditor-appellant's interest in the property and confirmed the plan, holding that nonvoting creditors were deemed to have accepted the plan. The district court affirmed the lower-court ruling that a nonvoting nonobjecting creditor, who is the only member of a class, is deemed to have accepted the plan for purposes of §1129(b). The court of appeals affirmed the lower court's decision, in large part on the grounds that creditors are obligated to take an active role in protecting their claims and cannot wait until after confirmation of a plan to complain about the distribution to be received. It is not clear whether this ruling is entirely relevant to the bankruptcy court's second decision in *DBSD*, since it appears to be more focused on the timing of the creditor's objection.

The decision reported in *DBSD* appears to follow the rulings of several cases: *In re P-R Holding Corp.,* 1477 2d 895 (2d Cir. 1945), a case decided under former Chapter X that dealt with the issue of a good-faith vote on a plan, and more recent cases such as *In re Dune Deck Owners Corp.,* 175 B.R. 839 (Bankr. S.D.N.Y. 1995), and *In re Allegheny Int'l. Inc.* 118 B.R. 282 (Bankr. W.D. Pa. 1990). As the court in *P-R Holding Corp., supra,* stated:

The mere fact that a purchase of a creditor's interests is for the purpose of securing the approval or rejection of a plan does not of itself amount to 'bad faith'. When the purchase is in aid of an interest other than an interest of a creditor, such purchases may amount of 'bad faith'… And certainly there is 'bad faith' when those purchases result in a discrimination in favor of the creditors selling their interests.

Allegheny Int'l Inc. is a leading case on this issue. The plan proponent, Japonica Partners, bought up claims against the debtor to gain control and block its confirmation of a competing plan. The bankruptcy court found that Japonica's attempt to take control was a purpose fundamentally different than the goal of creditors who desire to maximize their recovery. This effort by Japonica was deemed to be an ulterior motive aimed at gaining an advantage to which it would not otherwise be entitled, and its vote was disqualified.

Dune Deck Owners Corp. addressed the issue of whether a creditor's vote on claims purchased for the avowed purpose of defeating confirmation should be disqualified. In that case, the bankruptcy court addressed the issue of whether the creditor's vote was motivated by a legitimate concern over the treatment of its claim in the prospects for reorganization or an unrelated reason that the law condemns. The bankruptcy court found that votes are cast in bad faith when the holder of a claim (1) attempts to extract or extort a personal advantage not available to others, or (2) has an ulterior motive such as to procure some collateral or competitive advantage unrelated to the claim. Badges of bad faith as stated in *Dune Deck* are: (1) those designed to assume control, (2) those where the aim is to put the debtor out of business or gain competitive advantage, (3) those that destroy the debtor out of pure malice and (4) those whose purpose is to obtain benefits under a private agreement with a third party that are dependent on the debtor's failure to reorganize. The court found enough evidence to warrant a hearing on the good faith of the vote to be considered at the confirmation hearing on the plan.

The court's decision to confirm the plan in *DBSD North America Inc.* is novel in the way it applied the standards for confirmation under §1129(a). In doing so, it held that a negative vote, which was previously disqualified for bad faith, could be counted as an accepting vote to avoid cramdown under §1129(b). The bankruptcy court's decision, however, followed established precedents in finding bad faith when there is an ulterior motive to gain some competitive advantage unrelated to the interests of creditors.

1. *In re DBSD North America Inc., et al.*, 421 B.R. 133 (Bankr. S.D.N.Y. 2009).
2. *In re DBSD North America Inc.,* 419 B.R. 179 (Bankr. S.D.N.Y. 2009).