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Navigating Today's Environment

The Directors' and Officers' Guide to Restructuring

SECOND EDITION

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American Bankruptcy Institute

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5.II THE RISE OF THE RSA: DRIVING VALUE TO STREAMLINE NEGOTIATIONS IN A RESTRUCTURING PROCESS

LEGAL PERSPECTIVE

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Throughout the past decade, the use of the restructuring support agreement ("RSA") or sometimes referred to as "plan support agreement") has emerged as a staple of large financial restructurings in the United States and abroad. Historically, a debtor commencing a Chapter 11 case in a U.S. bankruptcy court would use the bankruptcy process to develop a business plan, eventually file a plan of reorganization, and then work to garner sufficient support to achieve confirmation. The high costs and uncertainty inherent in these often-lengthy bankruptcy cases drove parties to employ RSAs to expedite and provide clear direction to the restructuring. At its core, an RSA acts as a "lockup agreement," ensuring that the signing stakeholders — usually financial creditors, but sometimes shareholders or other stakeholders too — will support and not vote against a plan that is consistent with the terms of the agreed restructuring. In turn, the company agrees to prosecute the plan on the agreed-upon terms and timeline. When effectively used, an RSA can provide significant savings to a debtor's estate and reduce the uncertainty for both debtors and creditors over the course of a restructuring.

Overview of restructuring support agreements

An RSA generally serves different purposes from the perspective of the debtor and the creditors. For the debtor, the RSA memorializes the agreement of the executing creditors to support the debtor's proposed restructuring plan, eliminating uncertainty surrounding the company's future. Entering Chapter 11 with an RSA also reduces potential negative implications of a bankruptcy filing by signaling to the market the debtor is positioned to successfully reorganize and exit Chapter 11 as a going concern.

From the creditor's perspective, a restructuring support agreement provides more certainty regarding the timing and outcome of a restructuring, as well as an opportunity to potentially obtain improved economic terms, either through direct plan treatment or other fees commonly paid under an RSA.

Although RSAs are case-specific and will include varying terms, the key aspects of such agreements are outlined below.

Terms of the restructuring

A critical component of an RSA is the agreed-upon treatment of the claims of the signing creditors, as well as other key terms of the plan, such as the reorganized capital structure, the corporate governance of the reorganized company and any management incentive plan. It may also include a commitment regarding the proposed treatment of non-executing creditors.

Commitments of creditors

The RSA will bind executing creditors to vote in favor of a plan that is consistent with the terms of the agreed-upon restructuring. Creditors are also frequently bound to certain negative covenants, including an agreement not to propose or otherwise prosecute an alternative restructuring transaction and to not otherwise take any action that would impede the agreed-upon restructuring.

Since the primary purpose of the RSA from the debtor's perspective is to ensure a floor of support among executing creditors, RSAs will also typically bind creditors to restrictions on the assignment of their claims against the debtor. Generally, an RSA will provide that creditors can only trade or assign their claims against the debtor to either (1) another creditor that is already a party to the RSA, or (2) a party that agrees to sign the RSA and be bound by its terms. Absent such restrictions, a creditor could sell its claims free of the burdens of the RSA and the debtors could, in turn, lose critical support for the plan. To confirm that trading restrictions are adhered to, creditors are frequently required to report their holdings on a periodic basis or upon the request of the debtor.

Case milestones

One of the primary inducements for a creditor to enter into an RSA is certainty regarding the timing and trajectory of a case. Such commitments are enforced through deadlines, or case milestones, set forth in the RSA. The failure to meet such milestones typically creates a termination right in favor of the creditor parties. Such milestones can generally be extended on consent of the RSA parties. However, some RSAs require a super-majority of creditor support to extend milestones.

Typical case milestones include deadlines for (i) commencement of the Chapter 11 case (in the case of an RSA executed pre-petition), (ii) approval of post-petition financing and other "first day" relief, (iii) approval of a disclosure statement, (iv) confirmation of the plan and (v) the effective date of the plan. If the debtor has agreed to obtain court approval to assume the RSA, the agreement will likely include a deadline by which such assumption must be approved.

Termination rights

In addition to the case milestones, RSAs also include other rights for either the debtor or creditors to terminate the agreement upon the occurrence of certain events. Typical termination events include (i) a material breach of the agreement, (ii) conversion of the case to Chapter 7 or appointment of an examiner or trustee, (iii) entry of a court order that is materially inconsistent with the RSA (and such order is not stayed) and (iv) failure of the company to operate the business in the ordinary course.

Role of the board

From the board's perspective, the RSA is an important and useful tool in connection with any planned bankruptcy filing. As discussed above, an RSA can ensure that a company has a viable restructuring, reducing costs and uncertainty. However, because the terms of the RSA will set the stage for the entire case, it is critical that the board explore all restructuring options to ensure that the RSA is in the company's best interests.

To that end, one term that is particularly important to the board is the "fiduciary out," which enables the debtor to terminate the agreement and pursue a superior transaction.[2] An effective fiduciary out clause allows the debtor to terminate the RSA if

[1] Some versions of this provision simply allow a debtor to take — or refrain from taking — actions consistent with the board's fiduciary duties without breaching the RSA, but with no termination of the RSA itself.

the debtor determines the reorganization plan as outlined in the RSA is not in the best interests of the company. Because creditors may view a fiduciary out as giving the debtor a free option on the RSA, creditors sometimes try to narrow the circumstances under which the debtor can invoke it. However, most current fiduciary out provisions invoke a common formulation that allows for broad discretion in exercising fiduciary duties.[3]

From the board's perspective, the fiduciary out ideally authorizes the board to walk away from the RSA if the board determines that performance of the agreement would be inconsistent with the board's fiduciary duties. Boards almost always obtain this provision in RSAs, though creditors will often require that any such determination be made in good faith and on the advice of counsel.[4] Creditors may also only agree to an out for materially changed circumstances, which may set up a litigation as to what constitutes those circumstances.[5]

The inclusion of an effective fiduciary out is also important in connection with the court's approval of an RSA.[6] The presence of a fiduciary out signals to the court that the RSA was not coerced, is in the best interests of the debtor's estate and was entered into with sound business judgment.

Timing for entering into an RSA

To achieve the maximum benefit of reducing the costs associated with lengthy or uncertain bankruptcy cases, RSAs should ideally be signed prior to the commencement of the bankruptcy case, which is also known as the "petition date." With the proliferation of "pre-packaged" and "pre-negotiated" bankruptcies,[7] RSAs are predominately signed pre-petition.[8]

[2] Some more creative RSAs may have additional "fiduciary flex" provisions that expressly provide for additional options a board may take under specified circumstances, including forms of "go-shop" provisions that ensure the best possible deal for the debtor can be presented for approval to the bankruptcy court. See, e.g., *Declaration of Justin Bickle, Chief Executive Officer of Nordic Aviation Capital A/S and Chairman of the Restructuring Committee, in Support of the Debtors' Chapter 11 Petitions and Restructuring Transactions*, *In re Nordic Aviation Capital Designated Activity Company*, Case No. 21-33693 (KRH) (Bankr. E.D. Va. December 20, 2021) [ECF No. 6] describing RSA provisions for, in addition to traditional fiduciary out, a "fiduciary flex" provision to consider alternative restructuring proposals depending on changing facts and circumstances, in addition to a limited "go-shop" provision; *Declaration of Mark E. Yale, Executive Vice President and Chief Financial officer of Washington Prime Group Inc., in Support of the Debtors' Chapter 11 Petitions and First Day Motions, In re Washington Prime Group Inc.*, Case No. 21-31948 (MI) (Bankr. S.D. Tex. June 14, 2021) [ECF No. 26] describing RSA toggle between equitization restructuring and formal marketing process, subject to requirements that, *inter alia*, corporate funded debt be paid out in cash in full.

[3] See 24 Hour Holdings II LLC Restructuring Support Agreement at § 9(f) ("…if the board of directors, board of managers, or such similar governing body of any entity constituting the Company reasonably determines in good faith after consultation with outside counsel that continued performance under this Agreement would be inconsistent with the exercise of its fiduciary duties under applicable law").

[4] See Government Development Bank for Puerto Rico Restructuring Support Agreement at § 6(b)(xi), (limiting the fiduciary out to where "[t]he governing board of directors of GDB adopts a resolution determining, after consultation with counsel, that materially changed circumstances exist creating a material impediment to effectuating the Restructuring").

[5] See, e.g., *Debtor's Motion for Entry of an Order (A) Authorizing the Debtor to Assume the Restructuring Support Agreement and (B) Granting Related Relief*, *In re Security First Inc.,* Case No. 20-12054 [ECF No. 31] ("Importantly, the RSA contains a 'fiduciary out' provision. This provision ensures that, while the Debtor is contractually bound to comply with the RSA, the Debtor retains the right to pursue an alternative restructuring path in compliance with its fiduciary duties").

[6] An analysis of large Chapter 11 cases found that an average of 65 percent of the cases filed between 2016 and 2018 were pre-packaged or pre-negotiated filings, as compared with an average of 44 percent between 2010 and 2015. John Yozzo & Samuel Star, *For Better or Worse, Prepackaged and Pre-Negotiated Filings Now Account for Most Reorganizations*, 37 Am. Bankr. Inst. J., No. 11 (Nov. 1, 2018), https://www.abi.org/node/269843.

[7] 61 percent of 2021 Chapter 11 filings of debtors with at least $250 million in gross debt (based on Reorg Research data) entered Chapter 11 with a live

Pre-petition RSAs

For a pre-packaged bankruptcy — where the debtor has both negotiated and solicited votes on a plan before the commencement of a Chapter 11 filing — the RSA is generally executed before solicitation and without court approval. Because it is expensive and time consuming to solicit a pre-packaged Chapter 11 plan, many companies will only do so if they are confident they can consummate the restructuring with the support of the creditors executing the RSA. For a pre-negotiated (i.e., "pre-arranged") bankruptcy — where the debtor has negotiated the terms of a plan, but there has not yet been a formal solicitation of votes — the RSA is generally executed shortly before the filing.

Key factors affecting the timing of an RSA include the debtor's liquidity — or other circumstances affecting the urgency of bankruptcy protection — and the nature of the debtor's relationship with key constituencies prior to the commencement of a bankruptcy case. For example, a debtor commencing a "free fall" bankruptcy — i.e., where the debtor files for bankruptcy without any agreement with its creditors — usually does so with the primary purpose of preventing a rapid dissipation of enterprise value because of foreclosure or other creditor remedies. In these cases, there is rarely sufficient time or attention for a debtor to negotiate a restructuring prior to commencement of the case. Likewise, an RSA may not make sense if a debtor needs to file for bankruptcy because it faces distress from non-financial creditors such as tort claimants, which may require the automatic stay and other features of Chapter 11, like a Tort Victims Committee, to reach a global consensus on a restructuring. In contrast, a company with sufficient cash on its balance sheet and an effective working relationship with key creditors, notwithstanding its insolvency or impending default, often has additional runway to negotiate an RSA prior to the commencement of its case.

Post-petition RSAs

Even without the benefit of a pre-petition RSA, debtors can still benefit from signing an RSA after the petition date if the court approves, providing certainty and ensuring a viable exit from bankruptcy.[9] A debtor may also sign-up certain creditor constituencies to an RSA prior to bankruptcy but negotiate a separate support agreement with other groups during the pendency of the bankruptcy case. Of course, the more stakeholders signed up to an RSA at the outset of a bankruptcy case, the easier, quicker and more economical the proceedings will be.

Pre-petition RSAs as executory contracts

As noted above, entry into a pre-petition RSA can provide substantial benefits to a debtor by streamlining a Chapter 11 process and reducing uncertainty from the outset of a case. However, a pre-petition RSA provides less certainty to creditors because it may not be enforceable against the debtor in bankruptcy. Because a pre-petition RSA will have material performance obligations remaining from all parties at the commencement of the bankruptcy, it is likely an executory contract enforceable against the counterparty during bankruptcy but subject to rejection by the debtor. As a result of this asymmetry, creditors party to pre-petition RSAs will often demand that the debtor assume the RSA to ensure enforceability.

Even without assumption, an RSA may provide other benefits to creditors, including ensuring the board's and management's support for a plan of reorganization, thereby creating momentum toward the completion of the negotiated restructuring. This momentum and the cost to the debtor of abandoning a deal can provide sufficient comfort to creditors when weighed against the cost of assuming an RSA that will typically remain subject to a fiduciary out. Additionally, financial creditors may have other levers of influence upon the Chapter 11 case, like case controls and covenants in debtor-in-possession financing, which may provide sufficient comfort to an RSA signatory that it can ensure the plan ultimately conforms to the RSA without its assumption by the debtor.

pre-petition RSA; just under half (44 percent) were pre-packaged cases.

[8] RSAs signed during a Chapter 11 case are sometimes referred to as "plan support agreements." They are functionally the same thing as a restructuring support agreement.

A motion to assume an RSA is typically subject to the business judgment standard.[10] But these motions can precipitate litigation over the proposed restructuring attached to the RSA. The objections to an RSA may cover the same ground that objections to a proposed plan will cover. Thus, assumption may simply provide another earlier bite at the apple for objecting parties to attack a deal for maximum leverage in negotiations.

Pre-petition RSAs negotiated with related or otherwise interested parties can face heightened scrutiny from a bankruptcy court.[11] For example, in *In re Innkeepers USA Trust*, the bankruptcy court declined to permit a debtor to assume an RSA where the RSA bound the debtor to favor certain secured creditors deemed to be not disinterested in the transaction.[12]

Approval of post-petition RSAs

A post-petition RSA would be subject to approval under section 363 of the Bankruptcy Code, which requires a debtor to seek court approval of any transaction that uses, sells or leases property of the estate and would occur "other than in the ordinary course of business."[13] The standard of approval is similarly deferential to the debtor's business judgment, unless conflicts or other circumstances necessitate heightened scrutiny.[14]

The enforceability of a post-petition RSA requires a fact-intensive analysis and may be problematic because of potential violations of the requirements of section 1125(b), which prohibits solicitation of votes on a plan before the court approves a disclosure statement. In one decision, the Delaware Bankruptcy Court in *In re Indianapolis Downs, LLC* held that it could enforce a post-petition RSA where the creditor parties to the agreement are sophisticated and fully informed and are required to vote on a plan only after receiving a court-approved disclosure statement.[15]

Other legal issues facing RSAs

In addition to the key terms outlined above, RSAs also often serve as a vehicle for delivering other economic benefits to executing creditors. For example, non-pro-rata backstop or other fees to certain creditor parties to RSAs are common and sometimes feature in disputes involving RSAs. Creditors left out of equity backstop financing arrangements, and the frequently valuable economics associated therewith, often challenge such fees embedded in RSAs on several grounds, including that they are improper uses of estate resources and result in inequitable treatment of creditors.[16] In addition, unsecured creditors who sign an RSA often seek to have their professionals compensated by the estate under the RSA. Courts may require the creditors to show they made a "substantial contribution" prior to approval of such fees.[17]

[9] A court will grant a motion to assume a pre-petition RSA "upon a showing that the debtor's decision to take such action will benefit the debtor's estate and is an exercise of sound business judgment." *In re Genco Shipping & Trading Ltd.*, 509 B.R. 455, 462 (Bankr. S.D.N.Y. 2014).

[10] See 7 Collier on Bankruptcy ¶ 1108.07 (Richard Levin & Henry J. Sommer eds., 16th ed. 2015), (…"[c]ourts have employed what has been described as a 'sliding scale' of scrutiny, with the most searching standard of review being accorded to…transactions in which there is a potential for managerial self-dealing").

[11] 442 B.R. 227, 231 (Bankr. S.D.N.Y. 2010).

[12] 11 U.S.C. §363(b).

[13] See *In re Residential Capital, LLC*, 2013 WL 3286198 (Bankr. S.D. N.Y. 2013).

[14] 486 B.R. 286 (Bankr. D. Del. 2013).

[15] See, e.g., *Objection of GMO Credit Opportunities Fund, L.P. and Glob. Credit Advisers, LLC to Debtors' Motion to Approve Backstop Commitment Agreement*, *In re Bonanza Creek Energy*, Inc., No. 17-10015-KJC (Bankr. D. Del. Feb. 3, 2017) [ECF No. 224]; *Objection of the Mangrove Partners Master Fund, Ltd. to Debtors Motion for an Order Approving Backstop Commitment Agreement*, *In re Peabody Energy Corp.*, No. 16-42529 (Bankr. E.D. Miss. Jan. 12, 2017) [ECF No. 1961]; *Objection to Motion for an Order Authorizing the Debtors to Enter into Backstop Agreement*, *In re CHC Grp., Ltd.*, No. 16-31854 (Bankr. N.D. Tex. Nov. 10, 2016) [ECF No. 1164].

[16] In a widely noted bench ruling on December 14, 2020 in *In re Mallinckrodt PLC*, Case No. 20-12522 (JTD) (Bankr. D. Del.), Judge Dorsey applied the "substantial contribution" standard to a request for reimbursement of unsecured creditor fees pursuant to a pre-petition RSA (not yet assumed). Judge Silverstein in *In re Boy Scouts of America and Delaware BSA, LLC*, Case No. 20-10343 (LSS) (Bankr. D. Del.) issued a similar oral ruling on August 19, 2021, applying the same standard to fees to be reimbursed pursuant to a post-petition RSA.

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