

Ninth Circuit Decision Restricts Claim Purchasers' Ability to Block Reorganization Plan

A recent decision by the Ninth Circuit Bankruptcy Appellate Panel may indicate the increasing resistance of courts to permit secondary market claim purchasers to influence reorganization proceedings. In *In re: Windmill Durango Office, LLC*,¹ the court held that a claim purchaser could not change the vote cast by the seller even though the ballot deadline had not yet passed. In affirming the bankruptcy court's decision, the Panel reasoned that there was no basis for permitting a change of vote where a purchaser's only purpose is to obtain a strategic advantage with respect to its other interests in the case. This decision, along with the Second Circuit decision *In re: DBSD America, Incorporated*,² may signal a trend in bankruptcy law that courts will restrict the ability of claim purchasers to affect plan confirmations and the reorganization process.

In re: Windmill Durango Office, LLC

Windmill Durango Office, LLC was a single asset real estate debtor, with an outstanding secured mortgage debt of approximately \$16 million owed to Beal Bank and aggregate unsecured, non-priority debt of approximately \$14,000 owed to four creditors. The debtor proposed a plan of reorganization that placed its creditors in two classes. Beal was the sole member of Class 1 and the four unsecured creditors were assigned to Class 3. Two of the four Class 3 creditors withdrew their claims before votes were cast on the debtor's proposed plan.

The debtor's proposed plan called for it to pay a lower interest rate to Beal on the balance of the mortgage with a balloon payment after ten years, and the unsecured creditors 100 percent of the amount of their claims (interest free) within 90 days after confirmation of its plan. Beal argued that by establishing two classes, the debtor was

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¹ NV-11-1738-DKiPa (B.A.P. 9th Cir. 2012).

² 634 F.3d. 79 (2010).

attempting to force a cramdown of the mortgage claim. Beal voted to reject the plan, but Class 3 voted to accept it. Under the cramdown provisions of the Bankruptcy Code, the debtor's plan could be confirmed over Beal's objection if one other impaired class (such as Class 3) voted to accept it. Beal then purchased one of the Class 3 claims (before the ballot deadline) and brought a motion to change the vote originally cast by the seller.

Beal acknowledged that its purchase of the Class 3 claim was consummated solely to change the vote and thereby block confirmation of the plan. At the same time, it claimed that the debtor had created an artificially impaired class, Class 3, as the debtor had enough cash on hand to pay the claims. Beal claimed that this was done in bad faith in an effort to force a cramdown. The bankruptcy court held that Beal did not establish cause to change the vote of the acquired Class 3 claim, noting that cause to change a vote already cast must consist of more than simply a change of heart on the part of the creditor and, further, that purely strategic reasons do not constitute cause.

On appeal, the Panel upheld the bankruptcy court's ruling. However, the Panel limited its review to whether the bankruptcy court had abused its discretion. A close reading of the opinion suggests that if the judges on the Panel had originally heard the case, the outcome might have been different. Notably, the Panel called this decision a "close question." Accordingly, the precedential value of this decision may be limited in other jurisdictions.

In re: DBSD North America, Incorporated

Windmill is instructive, particularly in light of the Second Circuit's 2010 decision in *In re: DBSD North America, Incorporated*. In this case, DISH Network, a business competitor of the debtor, purchased claims against the debtor on the secondary market and used these claims to vote against a chapter 11 plan that frustrated DISH's efforts to acquire DBSD's assets. The court ruled that the votes cast by DISH in connection with the claims, which were cast in an effort to block the bankruptcy plan (like Beal's in *Windmill*), were "not in good faith," and should thus be designated and disregarded for voting purposes. The court reasoned that DISH was not concerned with protecting the viability of its purchased claims; rather, it wanted to gain access to a strategic asset of the debtor. By exercising the votes associated with its purchased claims, DISH would have been able to reject any plan that did not provide it with access to the assets. The court noted that its decision was not a categorical prohibition on purchasing claims with acquisitive or other strategic intentions. Rather, in this limited holding, the court clarified that when claims are purchased to obtain a blocking position and control the bankruptcy process to obtain a potentially strategic asset, votes associated with such claims may be designated and disregarded because such votes may be considered to have been made with an ulterior motive and thus not in good faith.

Conclusion

The *DBSD* and *Windmill* decisions are recent examples of courts resisting efforts by claim purchasers to control a plan confirmation process and, ultimately, the reorganization of a debtor. While the precedential value of *Windmill* may be limited, claim purchasers considering actions similar to Beal's and DISH's should proceed with caution as these decisions highlight the fact that courts will examine a claim purchaser's timing, intentions, and motivation. If possible, claim purchases should be completed before any votes on a plan are cast because once a creditor has voted, the purchaser may be precluded from changing it even if the deadline for submitting ballots has not yet passed. If claims are purchased after an original creditor has cast its vote, the purchaser should be prepared to show cause greater than strategic benefit to withdraw and recast the original creditor's vote.

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