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DESIGNATION OF CHAPTER 11 PLAN VOTE BY A BUYER OF LOANS

Credit agreements generally permit a lender to sell or assign all or a portion of its interests in loans to another party subject to certain conditions. Once the assignment becomes effective, the assignee becomes a "lender" under the credit agreement for all purposes, including with respect to voting rights and obligations owing to it from the borrower. Although it is well-established in the loan markets that the loan purchaser will need to meet only the assignment provisions in the credit agreement in order to obtain all of the rights of a selling lender, certain provisions of the Bankruptcy Code can affect such rights.

If the borrower files for bankruptcy, a creditor whose claim is "impaired" and who will receive or retain property under a chapter 11 plan will have the right to vote its claim. Under certain circumstances, however, the creditor may lose its right to vote on a plan based on its conduct. Pursuant to section 1126(e) of the Bankruptcy Code, "the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title."

"Designation" of a vote means that the vote is disqualified or disallowed. The statute does not explain what type of conduct constitutes a lack of good faith. Instances of such conduct identified by the courts can be grouped into three general categories:

1) Use of obstructive tactics or holdup techniques by a creditor to extract better treatment for its claim than for the claims of similarly situated creditors in the same class;
2) Casting a vote for the ulterior purpose of securing some advantage to which the creditor would not otherwise be entitled; and
3) Casting a vote motivated by something other than protection of a creditor's own self-interest.

"Badges of bad faith" include votes designed to assume control of the debtor, put the debtor out of business or otherwise gain a competitive advantage, destroy the debtor out of pure malice, or obtain benefits available under a private side agreement with a third party that depends on the debtor's inability to reorganize. Standing alone, however, a creditor's "selfish motive" for casting its vote is not a basis for

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disqualification under section 1126(e). Given the practical ramifications of barring an impaired creditor from exercising a fundamental entitlement, most courts consider designation to be the "exception rather than the rule" or even a "drastic remedy."

In *In re DBSD North America, Inc.*, a recent decision by the United States Bankruptcy Court for the Southern District of New York, the court designated a debt purchaser's vote on a chapter 11 plan of reorganization pursuant to section 1126(e) of the Bankruptcy Code when the purchaser acquired the debt, at par, after the debtor had filed its chapter 11 plan, with the purpose of voting to reject the plan in order to take control of the debtor. This decision has raised questions in the loan market about the strategy of purchasing bank debt as part of a process to acquire a distressed target.

The facts of the case are straightforward. DBSD North America, Inc. is a development-stage enterprise formed in 2004 to develop an integrated mobile satellite and terrestrial services network to deliver wireless satellite communication services to mass-market consumers. DBSD North America, Inc. and its subsidiaries (the "Debtors") filed an amended chapter 11 plan of reorganization to, among other things, satisfy their first lien secured pre-petition debt through issuance of a modified promissory note.

Shortly after the Debtors filed their amended plan, DISH Network Corporation ("DISH")—which had a significant investment in TerreStar, a direct competitor of the Debtors—acquired all of the Debtors' first lien bank debt at par. A DISH affiliate acquired certain second lien convertible notes after determining that the sellers of the notes were not bound by a plan support agreement.

DISH voted all of its claims against the Debtors' chapter 11 plan, and as a result, the class of first lien bank debt voted to reject the plan. The Debtors sought an order designating the vote of the first lien debt. The bankruptcy court granted the Debtors' motion to designate the vote. The bankruptcy court found that DISH purchased the debt as a strategic investor, and that "DISH made its investment in this chapter 11 case, and has continued to act, not as a traditional creditor seeking to maximize its return on the debt it holds, but as a strategic investor, 'to establish control over this strategic asset.'"

The bankruptcy court's ruling was affirmed by the United States District Court for the Southern District of New York, and it is currently on appeal in the United States Court of Appeals for the Second Circuit. The outcome of the appeal will be important to prospective strategic investors that might want to purchase loans of a distressed target in order to effectuate a strategic transaction and do not want to risk designation of their vote.

The Loan Syndications and Trading Association ("LSTA"), a not-for-profit trade association representing a membership that is involved in the commercial loan market, has filed an amicus brief, urging the Second Circuit court to reverse the lower court's ruling. The LSTA argued that the desire to engage in a strategic transaction with the Debtors alone does not constitute bad faith. The LSTA further claimed that "it is for the creditor, and the creditor alone, to decide what is in its economic interest, and refusing what a court might perceive to be a 'good deal' is not evidence of bad faith." Additionally, LSTA noted that the lower court's interpretation of section 1126(e) reflects an aversion to strategic acquirers that may reduce creditor recoveries and successful reorganizations.

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