BANKRUPTCY COURT DESIGNATES VOTES OF INVESTOR SEEKING TO ACQUIRE CONTROL OF THE DEBTOR

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To Our Clients and Friends:

In a recent decision in the Chapter 11 proceedings of DBSD North America, Inc. and its subsidiaries ("DBSD"), the United States Bankruptcy Court for the Southern District of New York "designated," or disqualified, DISH Network Corporation's ("DISH") votes to reject DBSD's proposed plan of reorganization. The court determined that DISH had not acted in good faith when, after DBSD had proposed a plan which would have satisfied the first lien debt through the issuance of a modified promissory note, DISH purchased all of DBSD's first lien debt at par, as well as a considerable amount of DBSD's second lien debt. Based on a variety of factors, the court concluded that DISH had acted with the intent to defeat the plan and to acquire control of DBSD. Although designation remains an extraordinary remedy, the decision in *In re DBSD North America, Inc.*, 421 B.R. 133 (Bankr. S.D.N.Y. 2009) may have important implications for investors seeking to gain control of a distressed company through the bankruptcy process.

Section 1126(e) of the Bankruptcy Code permits a court to designate any claimant's acceptance or rejection of a plan that was not in good faith or that was not solicited or procured in good faith. The Bankruptcy Code does not define "good faith," but case law has established that a lack of good faith may be evidenced where a creditor's motive is to secure an advantage that is either unrelated to its interest as a creditor or that is not available to other creditors in the class. Courts have identified certain "badges" of bad faith that may provide good reason for designation, including votes intended to destroy the debtor's business, to gain a competitive advantage or to acquire control of the debtor.

In granting DBSD's motion to designate, Judge Robert E. Gerber determined that DISH had purchased and voted its claims not as a creditor seeking to maximize the return on its investment, but instead as a "strategic investor" seeking to gain control of a valuable asset. Describing the facts before him as very similar to those in *In re Allegheny Int'l Inc.*, 118 B.R. 282 (W.D. Pa. 1990), a case in which the court designated the votes of a claim purchaser seeking to assume control of the debtor, Judge Gerber inferred impermissible intent based on the timing and the manner of DISH's acquisition of DBSD's debt. First, DISH acquired the first lien debt *after* DBSD proposed its plan of reorganization, such that it was a "voluntary claimant" that could have opted not to become a creditor if it determined the proposed distribution to be unsatisfactory. Second, DISH purchased the first lien debt at par, an investment for which it admitted overpaying and which did not make financial sense. Judge Gerber also pointed to a proposal by DISH to enter into a "major transaction" that he

viewed *in camera*, as well as certain internal DISH documents which suggested such a strategy. Finally, Judge Gerber was troubled by DISH's submission of a competing plan just a few days after DISH had argued against designation on the grounds that it had not proposed a competing plan.

Also of note is Judge Gerber's ruling on the consequences of designation in a case where a creditor has purchased all of the votes in a class.[1] Section 1126(c) of the Bankruptcy Code provides that a class of claims has accepted a plan if the plan has been accepted by creditors (other than those whose votes have been designated) that hold at least two-thirds in amount and more than one-half in number of the allowed claims held by creditors (other than those whose votes have been designated) that actually vote on the plan. Generally, votes that have been designated are simply ignored in determining whether a class has accepted or rejected a plan. However, because DISH purchased *all* of the claims in the class of first lien debt, ignoring DISH's votes would be meaningless. Even if DISH's votes were disqualified, the class would still effectively reject the plan because no creditors would be left to vote to accept the plan. Although this issue had never before been decided, Judge Gerber reasoned that this could not possibly be the correct result and held that the entire class was to disregarded, such that its acceptance would not be required for plan confirmation. In the alternative, Judge Gerber held, if the class must be considered, the designated votes should be deemed accepting votes such that the class would be deemed an accepting class.

The decision has been appealed to the United States District Court for the Southern District of New York.

Please feel free to contact us with any questions.

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[1] *419 B.R. 179 (Bankr. S.D.N.Y. 2009).*