

VOTE DESIGNATION IN CHAPTER 11

Reference: Wachtell, Lipton

Section 1126(e) of the Bankruptcy Code allows a court to designate - i.e. not count - the vote of any creditor whose vote is not cast in "good faith".

See *In re Allegheny International, Inc.*, 118 B.R. 282 (Bankr. W.D. Pa. 1990) in which an investor bought blocking positions in two classes of claims in order to defeat the debtor's reorganization plan and promote its own (which would have given it control of the reorganized company). The court determined that the investor had acted in bad faith in that his purpose was to take control of the debtor rather than recover the value of his claims. The court cited as evidence the fact that the investor had amassed its position only after the debtor had proposed a plan of reorganization and had purchased claims at highly inflated prices.

The most recent decision of interest came in the Southern District of New York *In re DBSD North America, Inc.*, No. 09-CV-10156, Docket Item No. 55 (S.D.N.Y. Mar 24, 2010). The District Court affirmed the Bankruptcy Court decision (which had relied principally on *Allegheny* in holding that acquiring claims "to establish control over a strategic asset" constituted bad faith. See *In re DBSD North America, Inc.*, 421 B.R. 133 (Bankr. S.D.N.Y. 2009).

DISH Network was a competitor of the Debtors. After the Debtors filed their POR and DS, DISH purchased all of the first lien debt at par, as well as certain subordinated notes. DISH made statements indicating its desire to obtain a blocking position and control a bankruptcy process relating to a strategic asset (a satellite system) which it sought to acquire.

The court concluded that DISH had the ulterior motive to use its status as a creditor to bypass the typical Chapter 11 takeover process (e.g. proposing a plan as an outsider or making a traditional bid for the company), unlike traditional creditors trying to maximize recovery on their claims. He designated DISH's votes.

DBSD is more likely to be limited to fact patterns involving competitors, purchases of claims late in the process (especially after a POR has been filed) and purchases of claim at or near par.

Look for an increase in 1126(e) litigation and would-be acquirers need to be careful.