



Pre-Packaged Chapter 11 Bankruptcy Cases

Pre-packaged Chapter 11 bankruptcy cases, such as the recent bankruptcy filing by McDermott International in the Southern District of Texas, rely on the debtor obtaining plan support agreements (PSAs). PSAs provide a well-defined structure for the Chapter 11 case and lay out terms negotiated between the debtor and its key creditors, usually before the bankruptcy case is filed. Such terms include an agreement to vote for and support the proposed plan of reorganization, and to not assign claims unless the assignee agrees to also support the proposed plan.

When creditors agree to support the proposed plan of reorganization, it can significantly reduce the cost of the bankruptcy case and perhaps most importantly, allow the debtor to emerge from bankruptcy quicker and with a large portion of its debt eliminated. Such a structure also reduces disruption to the debtor's customers and employees. Creditors also benefit from PSAs by obtaining agreements from the debtor such as favorable payment terms and a more definite timeline and outcome to the bankruptcy case.

When creditors agree to the terms of a PSA prior to the bankruptcy filing, they are entering into a contract with the debtor. After the bankruptcy case is filed, the debtor will then file a motion with the court to assume the PSA as an executory contract. The Court will typically approve the assumption of the PSA if it will benefit the debtor's estate and the agreement was made as an exercise of the debtor's sound business judgment. Notably, if a debtor does not seek approval to assume a pre-petition PSA, its creditors would be bound by the terms of the PSA but the debtor would not.

Less common are post-petition PSAs. When a debtor enters into a PSA with its creditors after the bankruptcy is filed, it must obtain court approval of the PSA since it is not an agreement a debtor would enter into in the ordinary course of its business, and it requires use of bankruptcy estate property. However, under Section 1125(b) of the Bankruptcy Code, debtors are prohibited from soliciting votes on a plan of reorganization before the disclosure statement is approved by the court. Notably, the Bankruptcy Code does not define "solicitation," and the majority of courts interpret the term narrowly so as to allow negotiation of a plan that may result in a successful reorganization of the debtor's business.

Based on the benefits conferred upon debtors and creditors through PSAs, we can expect the PSA trend to continue, especially in complex Chapter 11 bankruptcy cases.

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