April 26, 2024

Judge Glenn Rules Lockup Provisions Are Unenforceable When Counterparties Lack Adequate Information and "Meaningful Outs"

On April 22, 2024, in the chapter 11 cases of GOL Linhas Aéreas Inteligentes S.A. and its affiliates (collectively, the "***Debtors***"), Chief Judge Martin Glenn of the Bankruptcy Court for the Southern District of New York issued an opinion approving the economic terms of the Debtors' Stipulations (as defined below) with certain aircraft and engine lessors, but finding that certain Lockup Provisions (as defined below) contained therein were "impermissible" and "unenforceable" and should therefore be severed from the Stipulations.[1]

Background

The Debtors, which operate a Brazilian airline, commenced their chapter 11 cases on January 25, 2024. On March 28, 2024 and April 1, 2024, the Debtors filed four motions seeking approval to enter into certain agreements and stipulations (collectively, the "***Stipulations***") with various aircraft lessors (the "***Counterparties***"). The Stipulations resolved certain disputes between the Debtors and the Counterparties related to, among other things, unpaid rent, maintenance reserves, and the amendment and assumption of certain of the Counterparties' leases. The Stipulations also included lockup provisions (the "***Lockup Provisions***") requiring the Counterparties to: (a) support ***any*** chapter 11 plan later filed by the Debtors so long as (i) the plan embodies the terms of the Stipulations and (ii) the Debtors' liquidity and projected leverage ratio as of the plan's effective date satisfy certain minimum thresholds; and (b) vote against any other plan of reorganization filed by any non-Debtor party and refrain from supporting the filing of any such plan.[2] Notably, the Stipulations contained severability language providing that any ruling that the Lockup Provisions are unenforceable would not impact the enforceability of the Stipulations' other provisions.[3]

Objections to Lockup Provisions

Although no parties objected to the economic terms of the Stipulations, the official committee of unsecured creditors (the "***Committee***") and the U.S. Trustee filed objections to the Lockup Provisions.

The Committee's objection alleged, among other things, that the Lockup Provisions were "an impermissible solicitation of creditor votes" occurring "before the approval of a disclosure statement" and "without a meaningful ability for the [Counterparties] to change their votes as information changes."[4] The U.S. Trustee's objection largely echoed the Committee's objection, emphasizing that the Debtors were many months away from filing a plan and that the Lockup Provisions required the

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1 Memorandum Opinion Approving Settlements But Striking the Lockup Provisions from Stipulations with Lessors, *In re GOL Linhas Aéreas Inteligentes S.A.*, Case No. 24-10118 (MG) (S.D.N.Y. Bankr. Apr. 22, 2024) [ECF No. 510] ("***Opinion***").

2 *Id.* at 5.

3 *Id.* at 4.

4 Limited Objection of the Official Committee of Unsecured Creditors to Debtors' Motions to Approve Agreements with Aircraft Lessors, *In re GOL Linhas Aéreas Inteligentes S.A.*, Case No. 24-10118 (MG) (S.D.N.Y. Bankr. Apr. 3, 2024) [ECF No. 405] ¶ 17.

Counterparties to support any future plan filed by the Debtors without any "meaningful outs."[5] According to the U.S. Trustee, permitting the Lockup Provisions would: (a) disenfranchise creditor constituents; (b) undercut the value and leverage of other creditors in the same class who are not locked-up; (c) diminish the utility of the Committee and its ability to carry out its fiduciary duties; and (d) open the "floodgates" for the Debtors to "embark on a tactic of strong-arming enough unsecured creditors . . . into supporting an unknown plan."[6]

Judge Glenn's Decision

Judge Glenn approved the Stipulations subject to ruling that their severable Lockup Provisions were unenforceable. His opinion recited the standards for approving settlements, including the business judgment rule, but emphasized that "settlements cannot be allowed to trample on the rights and protections expressly created by section 1125 of the Bankruptcy Code."[7] Section 1125(b) provides:

> An acceptance or rejection of a plan may not be solicited after the commencement of the case . . . unless, at the time of or before such solicitation, there is transmitted to such holder the plan or a summary of the plan, and a written disclosure statement approved, after notice and a hearing, by the court as containing adequate information.[8]

Judge Glenn acknowledged that courts have narrowly construed "solicitation" in section 1125(b) to "relate to the formal polling process in which the ballot and disclosure statement are actually presented to creditors with respect to a specific plan"[9] and that courts therefore generally approve restructuring support agreements (commonly referred to as "***RSAs***") setting forth the basic elements of a chapter 11 plan and the parties' obligations to support the same. After analyzing cases finding that the negotiation and execution of RSAs did not constitute improper solicitation, he concluded that the "ingredients of a classic and unquestionably legal RSA" are "informed creditors knowingly and rationally agreeing to a particular plan structure or features and signing onto an agreement that creates consensus and moves the case forward."[10]

Judge Glenn contrasted such "classic RSAs" with plan support provisions—or "lockups"—that bind creditors to vote in a particular way, sometimes as an additional feature of an agreement completely unrelated to the ultimate structure of a plan. He noted that in *In re NII Holdings*, Judge Mary Walrath of the Bankruptcy Court for the District of Delaware announced a "bright line" rule against postpetition plan support agreements on the grounds that such agreements constitute improper solicitation in violation of section 1125.[11] Similarly, in *In re SAS*, Judge Michael Wiles of the Bankruptcy Court for the Southern District of New York found that a lockup provision, which was baked into a lease assumption agreement and obligated creditors to vote for ***any*** plan the debtors might propose, violated section 1125.[12]

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5 Objection of the United States Trustee to Debtors' Motions to Approve Agreements and Stipulations with Aircraft Lessors, *In re GOL Linhas Aéreas Inteligentes S.A.*, Case No. 24-10118 (MG) (S.D.N.Y. Bankr. Apr. 3, 2024) [ECF No. 406] at 6–7.

6 *Id.* at 2, 9.

7 Opinion at 12.

8 11 U.S.C. § 1125(b).

9 Opinion at 13 (quoting *In re Residential Cap., LLC*, No. 12-12020, 2013 WL 3286198, at *19 (Bankr. S.D.N.Y. June 27, 2013)).

10 *Id.* at 13–16 (citing *In re Heritage Org., L.L.C.*, 376 B.R. 783 (Bankr. N.D. Tex. 2007), *In re Indianapolis Downs, LLC.*, 486 B.R. 286 (Bankr. D. Del. 2013), and *In re Residential Cap., LLC*, No. 12-12020, 2013 WL 3286198 (Bankr. S.D.N.Y. June 27, 2013)).

11 *Id.* at 16 (citing Oct. 22, 2002 Hr'g Tr. at 60:19–23, 62:1–6, *In re NII Holdings*, Case No. 14-10979 (Bankr. D. Del. 2002)). Judge Glenn noted that while he preferred a more nuanced inquiry to Judge Walrath's "bright-line" prohibition, invalidating the specific Lockup Provisions before him did not require him to decide whether a bright-line prohibition was necessary or appropriate.

12 *Id.* at 17 (citing Sept. 28, 2022 Hr'g Tr. at 10:5–9, 18:1–5, 19:25, *In re SAS*, Case No. 22-10925 (Bankr. S.D.N.Y. 2022)

Comparing these cases to the cases approving lockup provisions in certain circumstances[13] and the cases approving classical RSAs, Judge Glenn concluded that the key factors relevant to evaluating the Lockup Provisions before him included whether the Counterparties had (a) adequate information about the terms of a potential plan and (b) meaningful choice or "outs."[14] In Judge Glenn's view, the Counterparties had neither. The Debtors had not yet formulated a chapter 11 plan and were "months aways" from filing a disclosure statement. Furthermore, Judge Glenn concluded that the Lockup Provisions' requirement that the reorganized Debtors satisfy certain minimum liquidity and projected-leverage-ratio thresholds did not provide the Counterparties with a meaningful "out" to "void the blank check they are writing."[15] He noted that there is a crucial difference between agreeing that settlement terms ***must be included in any plan***, and agreeing to vote for ***any plan that includes*** the settlement terms."[16]

Judge Glenn further emphasized his concern that the Debtors "may have bought the requisite votes to confirm a plan without input from, or regard for, any other creditors, essentially disenfranchising their votes at a nascent stage" in the Debtors' chapter 11 cases.[17] He noted that while the Counterparties' sophistication was a highly relevant factor in assessing the permissibility of the Lockup Provisions, "no level of sophistication allows parties to circumvent the Bankruptcy Code or use its provisions as bargaining chips."[18] Judge Glenn explained that while the Counterparties may wish to avoid a situation where the Debtors have complete control over their class of votes, they may "face a coordination game with other members of their class where each would rationally choose to sign the deal [*i.e.*, agree to the Lockup Provisions], lest they be left out in the cold."[19] In the resulting "tragedy of the commons," the Debtors may achieve complete control over a class, "a result which each counterparty may have been able to foresee, but which none would rationally cede their own bargain to avoid."[20] Judge Glenn concluded that section 1125(b) of the Bankruptcy Code guards against such "tragedy of the commons" by tying the hands of all parties, regardless of whether they are sophisticated. He therefore ruled that the Stipulations' severable Lockup Provisions were unenforceable.

Conclusion

Judge Glenn's decision finds that while lockup agreements can be valuable tools for forging support for a chapter 11 plan, their enforceability may be subject to question in certain circumstances, particularly where the non-debtor parties to such agreements have neither adequate information about the plan terms nor any meaningful ability to terminate their plan support obligations.

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13 *See, e.g.*, *In re Kellogg Square P'ship*, 160 B.R. 336, 338–39 (Bankr. D. Minn. 1993); Nov. 16, 2021 Hr'g. Tr., *In re Grupo Aeroméxico, S.A.B. de C.V., et al.*, Case No. 20-11563 (Bankr. S.D.N.Y. 2021).

14 *Opinion* at 22.

15 *Id.* at 22–25.

16 *Id.* at 24 (emphasis in original).

17 *Id.* at 22.

18 *Id.* at 25.

19 *Id.*

20 *Id.* 25–26.

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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