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EFH Ruling Impairs Creditor Reliance on Indenture Trustees

On Nov. 2, 2015, on the eve of Energy Future Holdings Corp.'s confirmation trial, the Delaware bankruptcy court ruled that where a majority of bondholders direct an indenture trustee to withdraw its confirmation objections, the remaining minority who did not file independent objections to confirmation may not step in to press the indenture trustee's objections. This ruling not only forecloses the litigation surrounding the minority bondholders' objections in the EFH case, but could also serve, as a practical matter, to impose additional filing requirements on creditors in future cases who rely on indenture trustees to press their claims.

Background

The dispute arose from a settlement agreement struck between the debtors and certain Energy Future Intermediate Holding Co. (EFIH) payment-in-kind noteholders (bondholders). In order to gain the settling bondholders' support of EFH's \$13 billion reorganization plan, the settlement agreement provided that settling bondholders, who constituted a majority of the ad hoc group of EFIH payment-in-kind noteholders, would receive the outstanding principal, accrued prepetition interest at the nondefault contract rate set forth in the EFIH payment-in-kind notes indenture, and 57.5 percent of their post-petition interest.¹ The agreement did not provide for recovery of interest by nonsettling bondholders. In exchange, the majority bondholders would direct the indenture trustee to withdraw its confirmation objections.²

Having relied on the indenture trustee to press their confirmation objections, the nonsettling minority bondholders sought to step into the indenture trustee's shoes to prosecute their claims. The minority bondholders argued that they had been entitled to rely on the indenture trustee to press their claims up until the debtors signed on to the settlement, four days after the objection deadline had passed.³ Thus, they argued, they should be

permitted to continue to assert the claims, which the indenture trustee had already been making on their behalf.⁴ The debtors opposed the minority bondholders and urged the court to enforce the objection deadline, arguing, in part, that the decision of those holders not to independently object had likely been strategic (to avoid discovery-related burdens) and should not be rewarded.⁵

The Court's Ruling

The court rejected the minority bondholders' argument, noting that the holders were sophisticated parties who had notice of the pending settlement agreement.⁶ The court criticized the minority bondholders for failing to file a joinder before the objection deadline, saying that they instead "sat on their hands"⁷ until the settlement deal was done, emphasizing that they knew or should have known it was possible the trustee would have to take direction from other holders who would take positions contrary to their own.⁸ In addition, the court agreed with the majority bondholders' view that EFH would be prejudiced if the minority bondholders could assert the confirmation objections, because EFH thought they reached a settlement that got rid of a major objector to the confirmation via the settlement agreement.⁹

Analysis

While the ultimate ramifications of the pretrial ruling remain unclear given that the EFH confirmation hearing has only just begun, the ruling is notable regardless of how the remainder of the hearing unfolds. First, as a general matter, it is not unusual for bankruptcy courts to make some accommodation for late objections, even by relatively sophisticated parties, where there is any mitigating circumstance to account for the objector's tardiness. In the case of EFH, regardless of whether the minority bondholders ideally should have filed their own objection by the deadline, the fact is that the indenture trustee had always acted on their behalf until that point in the case, and the trustee's objection remained pending at

the time of the objection deadline. Not allowing the minority bondholders to step into the trustee's shoes under those circumstances therefore, strikes one as a bit less forgiving than is typical.

Second, the prejudice to the debtors identified by the court was not of a nature that traditionally would be given great weight in determining whether to allow a late objection. That is because the mere loss of the ability to secure a victory without consideration of the merits typically is viewed as being more in the nature of a windfall than a legally cognizable prejudice. Cognizable prejudice typically goes to process (e.g., where a debtor has had insufficient time to prepare for trial as a result of a tardily imposed objection) rather than to the substance of the would-be objector's argument. Here, the prejudice identified by the court was to the debtors, but not because their ability to defend against an objection would be compromised by a late objection, but because they "thought that they reached a settlement and got rid of a major objector to the confirmation in a settlement agreement."¹⁰

Conclusion

Although the EFH confirmation hearing is still ongoing, pending different developments in this case or published guidance in future cases, individual noteholders who are relying on their indenture trustees to protect their rights would be well-advised to interpose their own individual objections and joinders so their arguments are not later foreclosed if the indenture trustee unexpectedly declines to act. And while distinguishable, one might argue by extension that any individual party in interest that is part of a group objection should be filing a separate joinder as

well, to protect itself in case of a group breakup. Time (and, perhaps, further developments in the EFH confirmation process) will tell whether joinders or independently filed objections in such cases become commonplace.

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- 1 See Amended and Restated Plan Support Agreement [DI 6699-1] at 2.
 - 2 *Id.* at 14.
 - 3 Hearing Trans. 13:9-24, Nov. 2, 2015.
 - 4 *Id.*
 - 5 *Id.* at 16:14-17:11
 - 6 *Id.* at 24:16-19.
 - 7 *Id.* at 22:5-7.
 - 8 *Id.* at 24:13-16, 22:5-9.
 - 9 *Id.* at 22:22-25.
 - 10 *Id.*
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