

Inside Counsel

<http://www.insidecounsel.com/2012/01/26/litigation-assignment-of-voting-rights-held-unenfo?ref=hp>

Litigation: Assignment of voting rights held unenforceable

Bankruptcy court allows a junior creditor to vote over objection by a senior creditor

BY [RANDYE SOREF](#)

January 26, 2012

In April 2010, SW Boston Hotel Venture LLC and certain related entities filed for Chapter 11 bankruptcy. Prior to the Chapter 11 filings, Borrower was indebted to both Prudential Insurance Company of America and the City of Boston. Prudential held the senior facility. In connection with such loans, Prudential and the city entered into an intercreditor agreement whereby Boston expressly agreed to assign its voting rights in any borrower bankruptcy case.

In support of plan confirmation, the City of Boston voted in favor of the plan, as did every other voting creditor class except Prudential. Prudential objected that the plan failed to enforce the intercreditor agreement and subordination of the city's voting rights. Prudential argued that the city lacked standing to vote based upon the express assignment of its voting rights.

Prudential further argued that the city should not receive any payments until Prudential was paid in full. Moreover, according to Prudential, because the intercreditor agreement required the city to assign its voting rights in any bankruptcy case involving SW Boston, Prudential held the city's vote and cast it to reject the plan. As a result, Prudential sought to invalidate the City of Boston's acceptance of the plan, and obtain a ruling that the city's vote was to reject.

In response, the City of Boston argued that the purported assignment of its voting rights was unenforceable as the parties couldn't contractually annul provisions of the bankruptcy code. The city further argued that it held additional collateral subject to its security interests and that such collateral was outside the scope of the intercreditor agreement. The City of Boston asserted, therefore, that Prudential had no right to insist on payment in full before the city could receive payment on account of the claims secured by the additional collateral.

Judge Joan N. Feeney of the Massachusetts Bankruptcy Court found that the assignment of Boston's voting rights to Prudential was unenforceable. Judge Feeney, while noting that 11 U.S.C. section 510(b) provides for the enforceability of subordination agreements, held, however, that "such agreements cannot nullify provisions of the Bankruptcy Code." As a result, the court invalidated the assignment of voting rights provision in the intercreditor agreement, and went on to confirm the plan using the cramdown provisions of 11 U.S.C. section 1129(a)(10) of the Bankruptcy Code.

As acknowledged by Judge Feeney, there is a split of authority regarding the "bankruptcy waiver" provisions granted by junior lenders in these types of second lien financing transactions. While Judge Feeney wasn't willing to enforce such provisions, other courts haven't questioned their enforceability and routinely approve similar agreements holding that the express assignment of voting rights in subordination agreements are presumptively valid under 11 U.S.C. section 510(a).

At some point, the issues must be resolved, but until then, senior lenders should beware that an express agreement assigning voting rights in a bankruptcy case won't always be enforced.

About the Author



Randye Soref

Randye B. Soref is a shareholder and administrative chair of Buchalter Nemer's Insolvency and Financial Solutions practice group. She focuses her practice on bankruptcy and insolvency proceedings, creditors' rights, corporate workouts and reorganizations and commercial litigation. She can be reached at (213) 891-5064 or rsoref@buchalter.com.