Simpson Thacher

Memorandum

Disclosure & Finality—The Real Lessons Behind the Third Circuit's Affirmation of the Bankruptcy Court's Reconsideration and Denial of a $275 Million Termination Payment

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On September 13, 2018, the Court of Appeals for the Third Circuit in *In re: Energy Future Holdings Corp.* affirmed the Bankruptcy Court's decision to reconsider and reverse its approval of a $275 million termination fee due pursuant to its bankruptcy court-approved Merger Agreement with EFH.[1] At first blush, the decision could be characterized as an inappropriate second-guessing of a crystallized break-up fee authorized under the Third Circuit's *O'Brien* test. Under closer review, however, that is not the case or import of the decision.

For those seeking bankruptcy court authorization (whether for a break-up fee, DIP financing, professional retention, or otherwise), the lessons from the decision are two-fold. First, disclose, disclose, and over disclose. As with all issues in bankruptcy proceedings, clear, transparent and unambiguous disclosure is a must, including disclosing: the circumstances under which a break-up fee *could* be payable—even if those circumstances may be atypical (and perhaps especially if that is the case); potential conflicts of interest in connection with professional retentions; and unique aspects of a DIP financing. The relevant disclosure should be expressly highlighted in the motion or application papers. It is not safe to assume that the court can or will scrutinize transaction documents attached to pleadings as exhibits, particularly if they are lengthy or technical. Agreements between sophisticated parties, such as debt documents, commercial contracts and acquisition or settlement agreements, frequently contain significant nuances and bespoke terms. Perhaps more so than any other area of law, members of the restructuring community—both investors and advisors—

[1] The Merger Agreement provided, among other things, that EFH would owe a termination payment to NextEra if regulatory approval was denied, *and* EFH terminated the agreement. Importantly, NextEra was not required to terminate if regulatory approval was not obtained. Not surprising, in order for EFH to pursue a different transaction, EFH was left in the untenable position of having to terminate the agreement, and pay the fee, while NextEra sat silently.

are laser focused on examining and dissecting these documents after the fact. If things go wrong, the original disclosure and representations to the court about the documents could be scrutinized and second-guessed. That was the case here. Had the Debtors fully described each circumstance in which payment of the termination fee could arise, the results likely would have been completely opposite. Judge Sonchi either would have approved the termination fee as written, in line with *O'Brien*—after considering, in light of all facts and circumstances, whether "the potential benefit [associated with the merger agreement] was outweighed by the harm that would result under predictable circumstances" if the fee were payable without another transaction in hand—or he would have declined to do so in advance of the transaction. By not focusing the judge up front on the possibility that a fee could be payable if regulatory approval was not obtained, the buyer moved forward at its peril—perhaps hoping the disclosure was sufficient—perhaps not considering the issue at all.

The second lesson is more doctrinal—it relates to the importance of ensuring that key rulings during a bankruptcy case are final rather than interlocutory. As discussed in the Third Circuit's decision, the time limits imposed on a motion to reconsider a final order are considerably more burdensome than those applicable to a motion to reconsider an interlocutory order. There are no specific time limits on a motion to reconsider an interlocutory order, but reconsideration of a final order is "subject to the time restrictions of Federal Rule of Civil Procedure 60" and, as in this case, when a reconsideration motion is "based on mistake, newly discovered evidence, or fraud," it "must be brought within one year….and under all circumstances… 'be made within a reasonable time.'" Thus, a threshold question for the Court was whether the Approval Order was interlocutory or final. In making that determination, the Court applied its "flexible, pragmatic approach to finality," which considers ""(1) 'the impact of the matter on the assets of the bankruptcy estate,' (2) 'the preclusion effect of a decision on the merits,' and (3) 'whether the interests of judicial economy will be furthered'" by an immediate appeal."

The Court concluded that the Approval Order was interlocutory, because, on its face, the Order "reserved questions for later determination" and as the Court noted "[e]ven in the flexible, pragmatic world of bankruptcy, "[f]inal does not describe th[e] state of affairs" when "parties' rights and obligations remain unsettled." Because, "at a minimum, the Order required the Bankruptcy Court to approve an allocation proposed by EFH and EFIH at a later date," the Court found that "the impact of the Order itself on the assets of the respective estates was both uncertain and far off" and the "[Termination] Fee could not be paid without further action [of the court]." Because the Bankruptcy Court found that the Approval Order was interlocutory, NextEra faced a much higher burden in establishing that the reconsideration motion was untimely.

The Court noted that the only viable timeliness argument NextEra could raise was the doctrine of laches, which would have required NextEra to demonstrate that Elliot, the proponent of the reconsideration motion, *inexcusably delayed* bringing the motion, and that NextEra was prejudiced as a result. The Court reasoned

that because of, among other things, the lack of clarity regarding the terms on which the Termination Fee was payable, it would not second guess the Bankruptcy Court's determination that Elliott had not *inexcusably* delayed the filing of its motion, which it brought shortly after NextEra claimed the fee was due.

With respect to bankruptcy orders governing sale transactions, financings, settlements or bid protections, such as a break-up fee or expense reimbursement, it is critical that the party seeking to later enforce the order ensure that the order does not require further judicial input as to its ultimate implementation—including, for instance, how a fee might be allocated among debtors or if conditions to a settlement require additional judicial review or input. In this case, it is unlikely that this issue alone would have precluded the Court from affirming the Bankruptcy Court's decision, nonetheless, it is an important consideration for other cases, where the facts may be less murky.

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