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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re:	)	Chapter 11
	)	
ARCAPITA BANK B.S.C. (c), ***et al.,***	)	Case No. 12-11076 (SHL)
	)	
Debtors.	)	Jointly Administered

LIMITED OBJECTION OF HARBOURVEST PARTNERS L.P.
TO DEBTORS' MOTION FOR AN ORDER APPROVING THE
DISCLOSURE STATEMENT AND GRANTING OTHER RELATED RELIEF

HarbourVest Partners L.P. and its affiliated funds who have filed proofs of claim in these chapter 11 cases, including Dover Arc LLC (together, "HarbourVest"), by and through the undersigned counsel, hereby file this Limited Objection to the Motion of Arcapita Bank B.S.C.(c) and its affiliated debtors and debtors in possession (collectively, the "Debtors") for an Order (I) Approving the Disclosure Statement and the Form and Manner of Notice of the Disclosure Statement Hearing, (II) Establishing Solicitation and Voting Procedures, (III) Scheduling a Confirmation Hearing, and (IV) Establishing Notice and Objection Procedures for Confirmation of the Debtors' Joint Chapter 11 Plan (the "Disclosure Statement Motion") [Docket No. 828]. In support of this Limited Objection, HarbourVest respectfully submits as follows:

PRELIMINARY STATEMENT

1. HarbourVest, through investment entity Dover Arc LLC, is a significant co-investor in the Debtors' investment portfolio, based upon complex, integrated contractual relationships that have been in place since June 2010. Fundamentally, HarbourVest's interests are aligned with those of the Debtors and all creditor constituents in these chapter 11 cases: all parties wish to maximize the value of the investment portfolio assets. HarbourVest does not contest the apparent conclusion of the Debtors and their creditors that value can be maximized through an orderly wind-down process, as contemplated in the Plan, under which the portfolio assets will be managed until desirable sale or other exit terms can be achieved.[1] HarbourVest is concerned, however, about the lack of specifics in the Disclosure Statement describing the proposed wind-down and related risks.

2. The Debtors' ability to maximize wind-down value depends on resolving a number of operational and contractual issues that depend, in turn, on apparently unresolved questions about who will oversee the wind-down and what the post-Plan corporate governance structure will be. The Disclosure Statement does not describe who will manage the Debtors' portfolio assets or how the investments will be structured during the wind-down, nor does it explain whether the reorganized Debtors and their non-debtor subsidiaries intend to – or, indeed, will be able to – keep in place material contracts related to their investments. Because the Disclosure Statement does not adequately describe the proposed post-Plan management and corporate governance structure or specify the

[1] Capitalized terms used but not otherwise defined herein shall have the meaning ascribed to them in the Disclosure Statement Motion.

treatment of key investment assets, it does not contain adequate information to permit creditors to determine whether to support the proposed Plan.

3. Among other problems, the Disclosure Statement gives essentially no insight as to who will manage the Debtors' portfolio companies – in which HarbourVest and other parties in interest have invested – and whether there will be a change of control that will adversely impact the value of the portfolio company assets and HarbourVest's and other creditors' investments. The Debtors and their non-debtor portfolio companies are party to numerous contracts, including co-investor arrangements such as those with HarbourVest as well as third-party financing arrangements, that contain change of control provisions and similar terms. Depending upon the specific structure of the proposed post-Plan corporate governance, these contractual terms may limit or prevent the reorganized entities and their portfolio companies from pursuing business-as-usual operations or otherwise maximizing operating value during the wind-down. For instance, the Plan may (and on its face appears likely to) run afoul of stock transfer restrictions in the Debtors' investment agreement with HarbourVest: to the extent the Plan contemplates the transfer of investments in portfolio companies interests to one or more new entities, it appears the Debtors and their non-debtor affiliates would have breached their co-investment agreements and could be subject to damages or other remedies. For the avoidance of doubt, HarbourVest has not been asked to waive any such change-of-control restrictions, is not at this time prepared to do so, and reserves all rights in that regard. Because the Plan and Disclosure Statement do not explain what the post-Plan corporate governance structure will be and do not disclose the significant risks of related disruption, including potential breach of key portfolio company contracts such as those with HarbourVest, it is impossible

to evaluate the business and operational impact of the Plan structure. Consequently, it is impossible to evaluate whether the Plan represents the best outcome for the Debtors' constituents.

4. Finally, the Plan and Disclosure Statement currently do not explain whether the Debtors will seek to reject key contractual arrangements related to the investment portfolio or whether those agreements will remain in place post-restructuring. HarbourVest recognizes that a disclosure statement may at times be approved before a debtor has fully completed its review of executory contracts. Sometimes, however, a particular contract or class of contracts is so material to the plan overall that its treatment must be set forth in the disclosure statement in order for creditors to fairly evaluate how to vote. That is the case here: the treatment of contractual arrangements with co-investors regarding the management and other aspects of the Debtors' investment portfolio will have a heavy impact on how assets are managed – and whether value will be maximized – going forward. Moreover, to the extent such contracts are to be rejected, co-investors may decide to assert claims that will need to be addressed and administered in the context of these cases. The Disclosure Statement should describe the Debtors' intentions with respect to this important class of contracts and should explain how assumption or rejection of the contracts will impact the Debtors' estates from the perspective of both wind-down operations and potential contractual claims.

5. HarbourVest supports the efforts of the Debtors and their major creditor constituencies to conclude these chapter 11 cases as quickly as practicable, in a manner that maximizes investment value. The Disclosure Statement in its current form does not provide adequate information, for the reasons described above, and must be augmented –

hence the filing of this Limited Objection. HarbourVest would support approval of the Disclosure Statement and moving forward with the plan confirmation process if and to the extent the Disclosure Statement is modified to add sufficient information about post-Plan corporate governance and the impact of the Plan on key co-investment and funding contracts for ongoing portfolio investments during the wind-down.

BACKGROUND

6. In 2010, HarbourVest (through its affiliate, Dover Arc LLC) and certain of the Debtors and their non-debtor affiliates entered into a co-investment arrangement through which HarbourVest purchased equity in several Cayman Island holding companies which in turn acquired direct or indirect interests in various Arcapita portfolio companies. The terms of the co-investment arrangement were set forth in a number of separately-documented but expressly integrated agreements (the "Investment Arrangement Agreement").[2] Among other things, the Investment Arrangement Agreement provides that day-to-day management of the portfolio companies is delegated to certain of the Debtors and their affiliates, but grants HarbourVest several important rights related to the co-owned portfolio companies, including restrictions on the transfer of interests, the right to appoint directors to serve on the boards of the various portfolio companies under certain circumstances, and the ability to terminate or modify the terms of the co-investment upon the occurrence of certain events.

7. On March 19, 2012, Arcapita Bank and several of its affiliates filed a voluntary petition for relief with this Court under chapter 11 of the Bankruptcy Code. The

[2] Each agreement contains an integration clause mandating that all agreements governing the co-investment relationship be read together to constitute one comprehensive understanding between the parties.

Debtors' chapter 11 cases have been consolidated and are being jointly administered pursuant to Rule 1015(b) of the Federal Rules of Bankruptcy Procedure.

8. Before the applicable bar date, HarbourVest filed proofs of claim against certain of the Debtors for (i) damages arising out of any breach of the Agreements and (ii) all other rights and claims arising with respect to the Agreements. Among other claims, HarbourVest is aware that the Debtors are currently holding approximately $1.5 million in dividend funds that were to have been transferred to HarbourVest but were mistakenly held in a bank account belonging to one of the Debtors, in breach of applicable contractual requirements. HarbourVest reserves all rights with respect to this contract breach and the funds in which HarbourVest asserts a beneficial interest.

9. On February 8, 2013, the Debtors filed the Plan and the Disclosure Statement. The Plan proposes to maximize the value of the Debtors' estates through an orderly wind-down and assumes a business-as-usual operation of Debtors' portfolio of investments until exits can be achieved at a time and in a manner that maximizes returns. As described in this Limited Objection, however, the Disclosure Statement lacks adequate information to allow a hypothetical reasonable investor to properly evaluate whether these objectives will be achieved under the proposed wind-down plan and therefore should not be approved.[3]

[3] In addition to this Limited Objection to the Disclosure Statement, HarbourVest reserves the right to object to the Plan in the event that a disclosure statement is approved and in the event a confirmation hearing is held. Nothing in this Limited Objection should be construed as approval of any Plan provisions, or a waiver of any confirmation objections.

OBJECTION

10. In its current form, the Disclosure Statement should not be approved because it does not meet the requirements of section 1125 of the Bankruptcy Code, which conditions the solicitation of votes accepting or rejecting a plan of reorganization upon a court's finding that a disclosure statement contains "adequate information." 11 U.S.C. § 1125(b). Bankruptcy Code section 1125 defines "adequate information" as information of a kind and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan." 11 U.S.C. § 1125(a)(1); *see In re Crowthers McCall Patterns, Inc.*, 120 B.R. 279, 300 (Bankr. S.D.N.Y. 1990) ("At the 'heart' of the chapter 11 process is the requirement that holders of claims in impaired classes be furnished a proper disclosure statement 'that would enable a hypothetical reasonable investor . . . to make an informed judgment about the plan'" (*quoting* H.R. Rep. No. 95-595, at 408-09 (1977)); *In re Ferretti*, 128 B.R. 16, 19 (Bankr. D.N.H. 1991) (disclosure statement "must clearly and succinctly inform the average unsecured creditor what it is going to get, when it is going to get it, and what contingencies there are to getting its distribution.").

11. The importance of full and adequate disclosure as required by Bankruptcy Code section 1125 is well-established. Courts repeatedly hold that "[t]he importance of full disclosure is underlaid by the reliance placed upon the disclosure statement by the creditors and the court. Given this reliance, we cannot overemphasize the debtor's obligation to provide sufficient data to satisfy the Code standard of adequate information."

Kunica v. St. Jean Fin., Inc., 233 B.R. 46, 54 (S.D.N.Y. 1999) (citing *Oneida Motor Freight, Inc. v. United Jersey Bank*, 848 F.2d 414, 417 (3d Cir. 1988), *cert. denied*, 488 U.S. 967 (1988)); *680 Fifth Ave. Assocs. V. EGI Co. Servs.* (*In re 680 Fifth Ave. Assocs.*), 209 B.R. 314 (Bankr. S.D.N.Y. 1997) (same); *Lionel Corp. v. Lionel Corp.* (*In re Lionel Corp.*), 722 F.2d 1063, 1070 (2d Cir. 1983) (holding that the key to the plan of reorganization is disclosure).

12. The Disclosure Statement as currently drafted fails to provide adequate information from which a "hypothetical reasonable investor" could make an informed decision about the Plan. Given the foregoing, the Court should not approve the Disclosure Statement unless the Debtors revise it to include the material information more fully described below.

A. The Disclosure Statement Fails to Provide Adequate Information about Post-Confirmation Governance of the Reorganized Debtors

13. The Disclosure Statement is clear that, if the Plan is approved, the "Reorganized Arcapita Group will wind down its operations and will not seek out new investors or investments." Disclosure Statement at 4. As such, the *only* function of the reorganized Debtors, and the *only* means for maximizing value to creditors, is the successful management of the Debtors' existing investment portfolio. But, the Disclosure Statement does not explain who will be responsible for this crucial investment management function or how existing contractual management arrangements for the Debtors' investments will be impacted by the Plan.

14. The Disclosure Statement states that the new parent holding company "shall be managed by a board of directors," that the "precise number and identity of, and the selection process for, the directors shall be specified no later than the Plan Supplement

Date," and that "[w]ith respect to the management and operation of the Reorganized Arcapita Group and the business enterprise as a whole, the Debtors intend to continue the employment of certain members of management and other key personnel to ensure the wind-down of the Debtors' assets occurs successfully and without interruption." Disclosure Statement at 4; Equity Term Sheet at 5.

15. Such disclosure leaves creditors with little assurance that the Debtors' wind-down strategy will be successful because it fails to disclose which, or how many, current employees will be engaged in managing the Debtors' investments despite the highly personal and talent-based nature of the Debtors' business. Further, the current disclosure does not acknowledge the significant impact of the post-Plan corporate governance structure on the Debtors' co-investment arrangements and management contracts going forward. Certain agreements governing the Debtors' co-investment arrangements – including key management agreements between co-investors and non-debtor portfolio entities – contain change of control provisions or other terms that could be triggered by the Plan depending on who is managing Arcapita's investments and on similar terms of post-reorganization corporate governance and control. In particular, as described above, the co-investment arrangement with HarbourVest includes such provisions. Thus, it is possible that, absent consents from a number of co-investors, creditors and other parties in interest, the reorganized Debtors will face significant limitations on their ability to continue to manage the portfolio assets during wind-down as contemplated by the Plan. The extent to which such consents will be necessary, and the risk that such consents will prove difficult or impossible to obtain, is not described in the Disclosure Statement.

B. The Disclosure Statement Fails to Provide Adequate Information on the Effect of the Plan on Third-Party Financing Arrangements at the Portfolio Company Level.

16. HarbourVest has grave concerns about the negative impact a change of control with respect to the Debtors portfolio companies could have on the value of the Debtors' investments and those of HarbourVest. The Disclosure Statement clearly acknowledges the risk that the restructuring contemplated by the Plan could trigger "change of control" provisions in the financing agreements of some portfolio entities, resulting in a reduction of value of the applicable portfolio company. Disclosure Statement at 154–55. It does not, however, provide creditors with enough information to fairly evaluate this risk. Although the Debtors assert they have taken steps to "minimize the risk of triggering the 'change of control' provisions" at issue, the Disclosure Statement fails to include any indication of how that has been achieved since it does not include details on what these steps are, what governance structure of the portfolio companies will be (and hence what control changes may have been made) following confirmation of the Plan or whether any change of control will cause the Debtors to breach investment agreements restricting the transfer of interests and potentially subjecting the Debtors to contractual damages or other remedies.

17. There is no dispute in this case that the "value of the Arcapita Group lies in the underlying value and performance of its investment portfolio." Disclosure Statement at 154. Disruptions or defaults in financing for portfolio company operations would pose significant risk to the investment portfolio's value and performance. The Disclosure Statement does not provide sufficient information about the post-confirmation governance of the portfolio companies to permit the investors and creditors to evaluate whether the

proposed Plan and governance structure will indeed maximize return to constituents. Further, the Disclosure Statement does not adequately explain that, as a result of the risks associated with potential financing defaults, HarbourVest and similarly situated co-investors may ultimately choose not to support the Plan structure and may assert all contractual and legal rights in an effort to avoid value destruction associated with a change of control.

C. The Disclosure Statement Provides Inadequate Information About the Status of Co-Investment Agreements.

18. The Disclosure Statement provides that the "Plan rejects all of the Debtors' . . . executory contracts, except those contracts that are specifically listed on the Assumed Executory Contract and Unexpired Lease List." Disclosure Statement at 14. It does not, however, identify which contracts the Debtors consider to be executory or which of those executory contracts the Debtors will assume or reject. Without knowing how the Debtors intend to treat their investment going forward, HarbourVest is unable to evaluate the Plan.

19. Given the nature of the co-investment arrangements and the Debtors business, whether or not the Debtors are able to achieve the objectives set out in the Plan will depend in large part on how co-investment contracts are treated. Co-investment agreements such as the Investment Arrangement Agreement with HarbourVest direct how day-to-day management of the portfolio companies will be effected and specify consent mechanisms and other arrangements related to the operations and exit from investments, among other things. The Disclosure Statement should set forth whether the Debtors believe the co-investment agreements are executory contracts susceptible to assumption or rejection and, if so, what election the Debtors will make regarding those contracts and

what, if any, cure obligations will be associated therewith. Absent this information, creditors will unable to evaluate the effect of assumptions or rejections, including the related risks and implications to the post-reorganization operations and value of the Debtors' investment portfolio.

20. Further, because the Debtors have not specified whether they can or will assume or reject the agreements governing their co-investment arrangements, investors in the portfolio company assets, including HarbourVest, are unable to determine what claims, if any, they have against the estate. If the Debtors intend to assume certain agreements governing a particular co-investment arrangement and not others, the Disclosure Statement should explain that the co-investor may have claims against the estate for damages in connection with some or all of the agreements (or may successfully argue that the agreements are integrated such that partial assumption or rejection is impermissible). Alternatively, if the Debtors intend to assume all of the contracts related to a particular co-investment arrangement, then the Disclosure Statement should explain that any such assumption would require the cure of defaults, set forth what cure payments may be required, and explain that the co-investor may (depending on the post-restructuring corporate governance structure) challenge assumption on certain grounds.[4] Put simply, unless the Disclosure Statement includes additional description of how co-investment contracts will be treated and what the associated risks and obligations will be, this court should deny the Disclosure Statement because it does not provide creditors with sufficient

[4] In this regard, HarbourVest notes that, as described above, the Debtors have breached their obligations under at least one of the integrated agreements making up the Investment Arrangement Agreement, which breach would be required to be cured if the Investment Arrangement Agreement were to be assumed.

information to evaluate the impact the plan will have on overall asset value and creditor recoveries, such that the creditor may decide whether to accept or reject the Plan.

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WHEREFORE, unless the Disclosure Statement is satisfactorily amended to address this Limited Objection, HarbourVest respectfully requests that this Court enter an order: (i) denying the Disclosure Statement Motion; and (ii) granting HarbourVest such further relief as this Court deems just and proper.

Dated: New York, New York
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Respectfully submitted,

/s/ M. Natasha Labovitz

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