AMERICAN
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# Innovations in Financing Chapter 11 Cases from the Petition to the Effective Date


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CONCURRENT SESSION

2021

# ABI PANEL DISCUSSION DEBTOR-IN-POSSESSION AND EXIT FINANCING

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## INTRODUCTION & OVERVIEW

- This panel will consider the financing needs of a Debtor from the DIP to the exit, and the various tools that have been deployed in recent cases to solve for financing needs
- We will also debate the pros and cons of some of these tools that have emerged in recent trends
- For purposes of keeping this panel entertaining, our panelists have agreed to adopt positions in response to the questions and their answers do not necessarily reflect their actual views

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# DIP Financing: Roll-Ups and Equity Conversion

## DIP FINANCING
DIP ROLL-UPS

- In recent cases there has been an increase in the use of “roll-up” DIPs – i.e. DIPs where prepetition lenders get all or a portion of their debt afforded DIP priority status in exchange for providing new money
- The ratio has been higher than 1:1 in some cases
- What do you make of this trend and where do you see it going

## DIP FINANCING
### DIP ROLL-UPS - PROS

- DIP roll-ups have been increasingly used as a required component of obtaining DIP financing
- In theory they are to be relatively rare, and only used when there is not another viable financing option
- When the alternative is to deny financing altogether, the roll-up may be the only financing solution for the case
- Roll-ups to enable financing which funds critical liquidity needs and enable case stability have been approved in many bankruptcy cases
- The roll-up requirement may be a requirement for the only tool available to prevent premature and value-destroying liquidation
- The retained amount following roll up plays an important role in developing and executing a viable plan confirmation status

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## DIP FINANCING
### DIP ROLL-UPS - PROS

- Roll-ups can also be narrowly tailored
  - Interim Amount Limited to Avoid Irreparable Harm
  - Revolver Rollups/the Creeping Roll
  - Rollup Amount: how much fresh availability is needed, and how much debt should survive for plan confirmation purposes
  - Revolver Advances vs Set Amount Advances
- Proceeds of the roll-up can be used to refinance applicable prepetition secured lenders to maximize the opportunities for a successful restructuring and a confirmable plan

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## DIP FINANCING
### DIP ROLL-UPS - CONS

- Some ongoing debate as to whether roll-ups are consistent with the structure of the Bankruptcy Code and should be permitted at all
  - (*See* Judge Jordan's recent concurring decision in *Reynolds v. ServisFirst* Bank, an 11th Circuit case considering roll-ups)
- Continued focus regarding
  - how much fresh money is needed to justify a roll-up,
  - whether the benefits of the additional liquidity outweigh the economic impact of the roll-up, and the dilutive effect of the balance of the DIP package
    - (*See* Unsecured Creditors' Committee's objection to DIP financing in Teligent)

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## DIP FINANCING
### DIP ROLL-UPS - CONS

- In some cases, DIPs are being done on a selective basis amongst prepetition lenders
- When roll-ups are involved, this changes prepetition claim amounts which could impact voting for confirmation (i.e. impact on prepetition claim amounts)
- Disparate treatment of similarly situated lenders should also be evaluated under the relevant credit agreements to assess voting and approval requirements
- Class acceptance via a plan can be an important tool to effectuate results when there is less than full agreement amongst prepetition lenders

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## DIP FINANCING
EQUITY CONVERSION

- Since the COVID pandemic began, we have seen Debtors in a number of cases, including some of the airline cases, seek approval of DIP facilities that included an equity conversion feature
- Is this a trend that you would expect to see going forward and is it one that we should want to see develop



## SUB ROSA PLAN ISSUES

- Latin term meaning something of a less pleasant fragrance being concealed “under the rose.”
- Sub rosa plans were first mentioned in the case of *Pension Benefit Guaranty Corp. v. Braniff Airways, Inc*. (In re Braniff Airways, Inc.) 700 F.2d 935 (5th Cir. 1983).
- The concern expressed by the court in *Braniff Airways* is that certain transactions entered into by the Debtor outside of the formal plan confirmation process will have "the practical effect of dictating some of the terms of any future reorganization plan" while "short circuit[ing] the requirements of chapter 11 for confirmation of a reorganization plan.”
- Similarly, the Second Circuit Court of Appeals in *Committee of Equity Security Holders v. Lionel Corp*. (In re Lionel Corp.) 722 F.2d 1063 (2d Cir. 1983), held that that a 363 sale which, in practical effect, resolves the entire bankruptcy case, constitutes a sub rosa plan of reorganization.
- The *Lionel* court further established the “business justification” test, which has become the preeminent standard to approve the sale of assets outside the ordinary course of business pursuant to § 363(b) of the Bankruptcy Code.
- DIP financing can invoke concerns similar to those raised by the courts in *Braniff* Airways and *Lionel* where it essentially binds the Debtor to a particular avenue of reorganization.
- By issuing future equity at a potential discount to postpetition lenders (who might also be prepetition equity holders in some cases), without the benefit of valuation or market-testing, DIP loans with an equity conversion component may be challenged on sub rosa grounds

## CASE STUDY: ASCENA DIP FACILITY

Case filed: July 23, 2020, in the Eastern District of Virginia

- Ascena Retail Group Inc. was the struggling owner of retail clothing chains Ann Taylor, LOFT, and Lane Bryant
- Ascena filed for Chapter 11 protection with an RSA approved by 68% of secured term lenders
- Goals of pre-arranged restructuring were to optimize balance sheet via reducing debt by approximately $1 billion, sell off certain intellectual property and e-commerce assets through a 363 sale process with a stalking horse bidder, and to continue operating the Ann Taylor, LOFT, Lane Bryant, Justice, and Lou & Grey brands through a reduced number of retail stores and online.
- Due to numerous complications relating to the RSA, Ascena took several months to finalize its DIP financing which consisted of:
  - (a) $400 million ABL facility; and (b) $312 million term loan, including $150 million in new money, which converts to exit financing upon emergence from Chapter 11

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## CASE STUDY: ASCENA DIP FACILITY (CONT.)

- DIP terms provided that:
  - All Term Lenders will: (a) have certain of their prepetition Term Loans rolled up into the debtor-in-possession financing, and the aggregate $311.8 million in loans (including the $150 million in new money loans) will be converted to a new first-out term loan facility upon emergence from these chapter 11 cases; and (b) receive their pro rata share of 44.9% of the equity in reorganized Ascena upon emergence from these chapter 11 cases
  - Term Lenders that participate in the New Term Loan Financing will also receive: (a) their pro rata share of 44.9% of the equity in reorganized Ascena; and (b) $88.2 million in new second-out term loans;
  - According to the RSA, "The DIP Facilities . . . provide material value to the Debtors' chapter 11 estates by sending a strong message to the Debtors' stakeholder that the Debtors will have sufficient liquidity to meet their cash needs and will continue to have sufficient access to capital after emergence from chapter 11 in light of the automatic exit conversion feature contained in the DIP Facilities."
- Ultimately, there were no formal objections directly relating to the equity conversion component of Ascena's proposed DIP financing, nor were there any formal objections which expressly raised the sub rosa plan issue

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## RECENT AIRLINE DIP FACILITIES

| Case | Key Features of DIP Facility | Initial DIP Lender(s) | Objections | Outcome |
|---|---|---|---|---|
| Avianca Airlines | Two-tranche convertible facility<br>• $1.27b senior superpriority Tranche A → new liquidity<br>• $722m superpriority convertible Tranche B → rollup of prepetition debt<br>Tranche B convertible to new equity at the company's option (only if the company deems it necessary and after conducting a market test) | Combination of prepetition lenders and new privately syndicated lenders | None | Approved |
| Grupo Aeroméxico | Two-tranche convertible facility<br>• $200m senior superpriority secured Tranche 1 Facility<br>• $800m superpriority secured Tranche 2 Facility<br>Tranche 2 convertible to new equity at the option of the DIP lender (upon satisfaction of heavily negotiated steps and conditions) | Combination of third-party financial institution and ad hoc group of bondholders | None | Approved |
| LATAM Airlines | Two-tranche convertible facility<br>• $1.3b Tranche A<br>• $900m Tranche C<br>Tranche C convertible to equity | Third parties and certain existing equity holders | Heavily contested by UCC, ad hoc bondholder group, and large unsecured creditors | Initially denied; subsequently approved with modifications |

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## CASE STUDY: LATAM CONTESTED DIP FACILITY

Case filed: May 26, 2020 in the Southern District of New York

- LATAM entered bankruptcy with commitments for $900 million of superpriority DIP financing from two significant shareholders, originally contemplated to be part of a three-tranche $2.2 billion facility
- Several stakeholders, including the UCC, filed objections to the proposed convertible DIP on substantive and procedural grounds. The main arguments included:
  - DIP represented self-dealing with the airline's controlling shareholders
  - DIP was not market tested prior to seeking approval; other creditors/consortiums were willing to provide the DIP on more favorable terms
  - DIP could not satisfy "entire fairness" standard (required because DIP was being provided by an insider)
  - DIP designed not to guarantee the debtors' repayment, but to give shareholders the exclusive option to forego payment and convert their DIP claims into new equity at a significant discount
  - DIP violated the absolute priority rule
  - Unreasonable interest and fees
- The UCC also argued that the equity subscription rights constituted an impermissible sub rosa plan because it locked in shareholders' ability to capture new equity early in the case

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## CASE STUDY: LATAM CONTESTED DIP

The bankruptcy court concluded that the conversion feature of the proposed DIP constituted an improper sub rosa plan

- The bankruptcy court rejected most of the arguments of the objectors by finding that:
  - It was appropriate for LATAM to seek approval of the full $2.45 billion facility
  - The facility resulted from fair dealing and reflected a fair price, thus satisfying the entire fairness standard
  - The financing satisfied the "new value" exception to the absolute priority rule
- Notwithstanding these conclusions, the bankruptcy court rejected the financing because it "subvert[ed] the reorganization process"
  - Credit agreement hard-coded discount to plan value without being market-tested
  - Covenant in the credit agreement provided that a plan that is not a "Company Approved Reorganization Plan" would lead to an event of default
  - Company did not have to seek court approval prior to election of equity conversion
  - The conversion feature "prematurely allocat[ed] reorganization value to LATAM's existing equity holders"

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## CASE STUDY: LATAM CONTESTED DIP

Following the bankruptcy court's decision and additional negotiations between the initial DIP lenders and the objectors, a revised DIP with no conversion feature was approved on a fully consensual basis

- The revised terms of the DIP, including removal of the conversion feature, addressed the bankruptcy court's sub rosa concerns

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# Process Terms, Milestones, Sale Processes

## PROCESS CONTROLS
MILESTONES

- Substantial negotiation and debate exists as to the extent to which case financing can and should dictate the contours of a chapter 11 case
- Process term are often required in a DIP facility and/or through exit financing commitments and backstops
- How should debtors and other stakeholders consider lenders' demands for tight milestones, requirements as to solicitation, expedited cases, and the like

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## PROCESS TERMS
### MILESTONES – PROS AND CONS

- Pros
  - Enables case funding and stability
  - Setting case timing expectations
  - Reduced administrative costs
  - Junior / trade creditors often unimpaired
- Cons
  - Potential need for flexibility/adaptation in process
  - Risk of default under DIP financing and potential consequences
  - If timelines are too short may challenge ability to maximize value

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## PROCESS TERMS
### SALES PROCESSES

- Senior secured lenders/DIP financing parties
  - have included sale-process milestones in DIP financings to effectuate disposition of assets and the ability to acquire assets via credit bid if adequate value cannot be realized
  - typically tied to defined and court approved bidding and sale procedures to authorize and facilitate asset dispositions

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## PROCESS TERMS
### SALES PROCESSES - PROS

- Enables market testing to occur while also providing for a stable transition process of assets if third party sale cannot be achieved which can be especially useful where valuation is uncertain or volatile
  - Process sale to senior lenders (*e.g.*, J.C. Penney, Neiman Marcus, Sheridan I and II, Nine Point Energy, others)
  - Process sale to third parties (e.g., Alta Mesa/Kingfisher, Approach Resources, others)
- Terms for credit bidding are set in bidding procedures and preserved in financing order
- Plan toggle rights activate if secured lenders provide the highest/best bid
- Sale may be closed via a plan of reorganization
- Sale on parallel path via 363 if plan is not confirmed



## PROCESS TERMS
### SALES PROCESSES - CONS

- Additional default triggers could lead to exercise of remedies and negative case consequences
- Unless debtor has solicited competitive proposals for DIP/exit financing, risk that these creditors will obtain undue leverage
- Short timelines that do not take into account marketing periods could effect “fire sale” scenario that chapter 11 seeks to avoid
- Exposure to volatility in market for short periods of time while trying to develop value maximizing scenario

# Exit Financing –Backstops and Rights Offerings

## EXIT FINANCING
BACKSTOPS

- The rise of backstops and rights offerings has dominated many cases in recent years, and the terms of such financings appear to be more favorable to the capital providers each year
- Are market forces or other factors driving this trend, or is there more going on behind the scenes

## RIGHTS OFFERINGS / BACKSTOPS

- A rights offering provides creditors or equity holders with the option (or right) to purchase new securities in a reorganized company at a set subscription price, often at a significant discount to plan value, during a set subscription period
- Key Components of a Rights Offering:
  - Price: Participants are offered the right to purchase securities, normally at discount to plan equity value. A larger discount increases the attractiveness, but it also increases the dilutive effect of the issuance on the parties unable or unwilling to participate
  - Section 1145 exemption: If the rights offering complies with § 1145 of the Bankruptcy Code, no SEC registration is required. Debtors may also use other exemptions in conjunction with § 1145 to avoid registration
  - Oversubscription right: The right to subscribe for unsold rights remaining after subscription period
  - Overallotment right: The right to purchase an additional, predetermined amount of interests should the offering be fully subscribed
  - Transferability: Rights offerings are typically non-transferable (except together with the underlying claim) to avoid jeopardizing registration exemptions
  - Backstop: One or more parties commit to subscribe for a minimum amount of the applicable securities, in return for a backstop fee (can be in the form of cash, equity or a note) and other consideration (e.g., breakup fee, expense reimbursement, minimum allocation / holdback)



## CASE STUDY: PEABODY ENERGY CORPORATION

Case Overview

Peabody, an American coal company, along with certain of its subsidiaries, filed for chapter 11 in April 2016. Prior to filing its petition, a dispute arose between the debtors' secured and senior-unsecured creditors regarding the extent of the secured creditors' collateral package. Upon filing, the debtors initiated an adversary proceeding seeking a declaratory judgment on the issue, and ultimately engaged in mediation with a group of holders of each of the second-lien and senior unsecured notes to resolve the dispute

The scope of the mediation ultimately extended to plan negotiations, and the mediation resulted in a reorganization plan as part of a complex global settlement of the mediation parties' issues. The proposed plan provided for, among other things, a $1.5 billion equity capital raise through a $750 million Rights Offering for reorganized common stock and a $750 million Private Placement through which participants received convertible preferred equity in the reorganized entity

- As set forth below, pursuant to these transactions, holders of second lien and Class 5B (senior unsecured notes) claims ultimately were able to purchase a significant amount of stock in the reorganized debtors at a discount and receive large premiums in exchange for agreeing to backstop the arrangement and support the plan

The debtors' plan was largely supported by all twenty classes of creditors, however, an ad hoc group of second lien and senior unsecured noteholders (collectively, the "Non-Consenting Creditors") objected to the plan, arguing that it violated the equal treatment rule of section 1123(a)(4) of the Bankruptcy Code because of the terms of the private placement and rights offering

- The Non-Consenting Creditors also submitted several alternate plan proposals, including an offer to backstop a $1.77 billion rights offering, but Peabody and the UCC rejected these proposals

The bankruptcy court confirmed the plan over the objections of the Non-Consenting Creditors and, on appeal to the district court, the district court affirmed the bankruptcy court's ruling. On August 9, 2019, the Circuit Court of Appeals for the Eighth Circuit issued a decision affirming the lower courts' decisions and upholding the debtors' plan


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## CASE STUDY: PEABODY ENERGY CORPORATION (CONT.)

Rights Offering Terms

Common stock offered at a 45% discount to Plan Equity Value

Eligible participants were holders of Allowed Second Lien Notes Claims and certain Allowed Unsecured Notes Claims (known as Class 5B)

Participants required to sign the Plan Support Agreement ("PSA") and Backstop Commitment Agreement ("BCA")

Private Placement Terms

Preferred stock offered at a 35% discount to Plan Equity Value

Eligible participants were holders of Allowed Second Lien Notes Claims and Class 5B Claims

Allocation was determined by Private Placement Agreement ("PPA"), which participating creditors were required to sign

Eligible participants were required to provide a full backstop of the private placement and Rights Offering pursuant to the BCA and sign the PSA

Private placement was implemented in three phases

- Phase 1 was limited to a small group of holders of Allowed Second Lien Notes Claims and Class 5B claimants who participated in the mediation. These creditors were given the exclusive right and obligation to purchase the first 22.5% of preferred equity in Phase 1. Phase 1 participants also had to purchase what remained of the 77.5% of preferred stock that did not sell in the next two phases
- Phases 2 and 3 were available to Phase 1 creditors and all other qualifying creditors who signed the PSA before certain deadlines
- Creditors who participated in the private placement were paid an aggregate $60 million backstop commitment premium and a $18.75 million ticking premium
  - All of the premiums were paid in common stock of the reorganized debtors

Holders of second lien and Class 5B claims were also entitled to recover significant portions of their claims pursuant to the plan, regardless of whether they participated in the Private Placement



## CASE STUDY: PEABODY ENERGY CORPORATION (CONT.)

Process Issues and Challenges Rights Offering Terms

The Non-Consenting Creditors objected to the plan, asserting that the plan impermissibly discriminated against holders of second lien notes claims and Class 5B claims because:

- Only those creditors within the class who voted in favor of the plan were permitted to participate in the private placement
- Only those creditors who participated in the mediation were permitted to participate in Phase 1 of the private placement, allowing them the opportunity to purchase 22.5% more preferred shares than creditors who could participate only in Phases 2 and 3 of the private placement

The objecting creditors further asserted that the plan was not proposed in good faith because: (i) it failed to maximize the value of the debtors' estate by selling the preferred stock at a discount, (ii) certain benefits were restricted to the parties who participated in the mediation and (iii) the coercive plan approval process induced holders to vote to accept the plan even if they could not participate in all aspects of the private placement

Lower Courts' Rulings

The United States Bankruptcy Court for the Eastern District of Missouri held that the plan did not violate the equal treatment rule of Section 1123(a)(4) of the Bankruptcy Code because the opportunity to participate in the private placement was not "treatment for" the participating creditors' claims. Rather, participation in the private placement was consideration for valuable new commitments made by the creditors – namely, to support the plan, purchase preferred equity that did not sell in the private placement and backstop the rights offering – in exchange for which they received the opportunity to buy preferred stock at a discount as well as premiums designed to compensate them for shouldering significant risks despite the volatile nature of the coal market

The bankruptcy court also found that the plan was proposed in good faith even though it provided for the sale of discounted preferred stock exclusively to certain qualifying creditors because the evidence supported that the debtors participated in mediation to resolve major inter-creditor disputes, the debtors reached the settlement with substantial input from the mediating parties and the objecting creditors could have intervened in the mediation

The Non-Consenting Creditors filed an emergency motion for a stay pending appeal, and the debtors (who by then had reorganized), joined by the UCC and other creditors, moved to dismiss the appeal as equitably moot. The District Court granted the debtors' motion to dismiss the appeal or, in the alternative, affirmed the judgment of the bankruptcy court and approved the plan on the merits. The Non-Consenting Creditors appealed the district court decision to the Eighth Circuit Court of Appeals

## CASE STUDY: PEABODY ENERGY CORPORATION (CONT.)

Eighth Circuit Decision

The Eighth Circuit followed other circuits in finding that "a reorganization plan may treat one set of claim holders more favorably than another so long as the treatment is not for the claim but for distinct, legitimate rights or contributions from the favored group separate from the claim." Accordingly, the Eighth Circuit reasoned that, here, "the opportunity to participate in the Private Placement was not 'treatment for' the participating creditors' claims. It was consideration for valuable new commitments made by the participating creditors. The participating creditors were investors who promised to support the plan, buy preferred stock that did not sell in the Private Placement, and backstop the Rights Offering. In exchange, they received the opportunity to buy preferred stock at a discount as well as premiums designed to compensate them for shouldering significant risk."

With respect to the "good faith" objection, the court explained that, although the term "good faith" is not defined in the Bankruptcy Code, in the context of a chapter 11 reorganization, "a plan is considered proposed in 'good faith' if there is a reasonable likelihood that the plan will achieve a result consistent with the standards prescribed under the Code." The court further explained that the "totality of the circumstances" surrounding the creation of the plan must be considered.

- The court concluded that the bankruptcy court did not clearly err in finding that the debtors proposed their plan in good faith, noting that the plan garnered tremendous consensus, with all twenty classes of creditors voting overwhelmingly to approve the plan, and approximately 95% of the debtors' unsecured creditors agreeing to participate in the private placement and make backstop commitments. The court also noted that the debtors permitted alternative plans to be proposed, all of which the debtors considered with their advisors

In response to the Non-Consenting Creditors' objection that the plan failed to maximize value, the court rejected the argument that the debtors could have raised more money selling their preferred stock at full price, rather than pursuant to the discounted private placement because, the court explained, the debtors may not have convinced the mediating parties to agree to the settlement and other terms of the plan without the opportunity to purchase the stock at a discount

The court was most sympathetic to the objecting creditors' concern that the debtors coercively solicited votes in favor of the plan because creditors wishing to take part in the private placement had to elect to do so before approval of all of the transaction agreements and the disclosure statement. However, the court ultimately agreed with the debtors that time was of the essence because of the volatile nature of the coal markets and took into consideration that the delay was likely to cost the debtors approximately $30 million per month in addition to other litigation costs



Case Overview

Pacific Drilling S.A., an offshore deepwater drilling company, and certain of its affiliates filed for chapter 11 protection in the Southern District of New York on November 12, 2017 and emerged from bankruptcy on November 19, 2018

The consensual plan of reorganization, which resulted from four months of intense mediation among certain fully secured debtholders, an ad hoc group of under secured creditors and the debtors' majority shareholder, provided for a $1.5 billion recapitalization, including (i) payment in full of all creditors (other than holders of impaired undersecured claims whose approximately $1.9 billion of debt was equitized under the plan), (ii) a balance sheet delevering and (iii) a new investment through a $500 million rights offering backstopped by the ad hoc group of undersecured creditors

The court denied the originally proposed rights offering notwithstanding that no parties objected to the proposed deal. In particular, in its September 18, 2018 decision, the court (J. Wiles) rejected the terms of the debtors' first proposed equity commitment agreement, and found that:

- no legitimate justification had been offered for the proposed $100 million private placement to the ad hoc group and
- the 8% backstop fee was not justified as to those portions of the proposed offering that were already fully committed, and could be paid only with respect to shares for which no commitments were yet in place

Following the September 2018 decision, the debtors submitted a revised deal that addressed the judge's concerns. The revised deal was approved on October 1, 2018, and the debtors' chapter 11 plan was confirmed on October 31, 2018

Original Rights Offering Terms

- $350 million rights offering
- $100 million private placement for ad hoc group
- $50 million private placement for majority shareholder
- 46.9% discount to plan value
- 8% backstop fee with respect to full $500 million

Revised Rights Offering Terms

- $460 million rights offering
- $40 million private placement for majority shareholder
- Removed $100 million private placement for ad hoc group
- 46.9% discount to plan value
- 8% backstop fee for the portion of the equity rights offering that had not yet been committed
- 5% fee for remainder

Originally Proposed Rights Offering

The original deal provided that the debtors' emergence from chapter 11 would be funded by a $500 million rights offering including:

- $350 million equity rights offering available to three classes of undersecured debt
  - Offered at 46.9% discount to the expected equity value under the plan
- $100 million private placement available only to the ad hoc group
- $50 million private placement that would obligate the majority shareholder to purchase 6.4% of the new common shares
- the ad hoc group would backstop the entire $500 million rights offering, including the $100 million private placement, in exchange for an 8% fee, payable in stock

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September 18, 2018 Hearing and Ruling Rejecting the Originally Proposed Deal

In its September 18, 2018 decision, the court rejected the terms of the originally proposed rights offering, finding that the deal (particularly the $100 million private placement to the ad hoc group) improperly amounted to paying a large group of creditors in exchange for their support of the plan

The court took issue with "special allocations and rights offerings or private placements that are limited to the bigger creditors who sit at the negotiating table, or big fees for backstops that are provided by the bigger creditors who are at the negotiating table but that are not even open to other creditors, and in particular to other creditors in the same class" finding "that it is far too easy for the people who sit at the negotiating table to use those tools primarily to take for themselves a bigger recovery than smaller creditors in the same classes will get"

The court further found that:

- no legitimate justification had been offered for the debtors' proposed private placement to the ad hoc group, noting that the private placement gave the ad hoc group a disproportionate share of the rights offering (Hrg. Tr. p. 22 § § 14-21)
- the debtors had failed to show the reasonableness of the proposed backstop fee with respect to those portions of the offering (the majority shareholder investment and the private placement to the ad hoc group) that were already committed. The court noted that the debtors provided "no out of bankruptcy market context in which people who are being given the exclusive opportunity to buy at an expected 46.9 percent discount were nevertheless also paid an 8 percent fee in exchange for their willingness to take advantage of that golden opportunity" (Hrg. Tr. p. 23 § § 7-12)

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Revised Rights Offering Terms

Following the September decision, the parties submitted a revised proposal that:

- eliminated the $100 million private placement to the ad hoc group
- provided for a $460 million rights offering that would be available to all three impaired secured classes and a $40 million direct investment from the prepetition equity sponsor
- the backstop parties would receive (i) an 8% backstop fee only for the portion of the equity rights offering that had not yet been committed and (ii) a 5% fee for the remainder of the equity rights offering

The entirety of the equity rights offering and a majority of the equity issuance were made available on a pro rata basis to holders of undersecured claims, as defined in the equity rights agreement, including the members of the ad hoc lender group

Even pursuant to the revised deal, the rights offering equity was offered at a 46.9% discount to expected plan value

On October 1, 2018, the court approved the revised deal, albeit reluctantly, in a bench ruling

- The ruling reiterated the court's concern with the reasonableness of the backstop fee and suggested that the debtors' business judgment was insufficient to justify the fee
- The court also expressed concern with how the deal was negotiated – in particular, that the ad hoc group participated in the negotiations whereas other similarly situated creditors did not (and the ad hoc group received a backstop fee that the others did not)
- Despite its concerns, the court noted that, because the deal was consensual, it was not the proper case for the court to intervene and undermine the deal


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## CASE STUDY: CHESAPEAKE ENERGY CORPORATION

Case Overview

Chesapeake Energy Corporation and its subsidiaries filed for chapter 11 in the Southern District of Texas on June 28, 2020, with an RSA executed by holders of 100% of its revolving loans, 87% of its FLLO term loans, and 60% of its second lien notes

The RSA and subsequently filed plan of reorganization contemplated a $600 million new money equity rights offering, which was backstopped in full by certain holders of the company's FLLO loans and second lien notes

Subscription rights to participate in the rights offering were distributed as follows:

- 25% of the common stock issued pursuant to the rights offering was reserved for the backstop parties
- 63.75% of the common stock issued pursuant to the rights offering was offered pro rata to holders of the FLLO loans
- 11.25% of the common stock issued pursuant to the rights offering was offered pro rata to holders of the second lien notes

The common stock was offered at a 35% discount to the plan equity value based on a total enterprise value of $3.25 billion

In exchange for their commitment to backstop the rights offering, the backstop parties were provided a fee of 10% of the aggregate amount of the rights offering payable in common stock issued at the 35% discount to plan equity value

Case Overview

California Resources Corp. (CRC) emerged from chapter 11 with a plan to eliminate $5 billion in debt from its balance sheet. The oil and gas company owns approximately 10,700 productive oil wells and 1,086 productive gas wells in the San Joaquin, Los Angeles, Ventura and Sacramento basins, with the Elk Hills field in the San Joaquin as its largest producing asset

The chapter 11 plan provided for $200 million in second lien exit financing, and $450 million raised through a rights offering

The October 13, 2020 confirmation hearing was uncontested, following a settlement with the UCC that gave unsecured creditors warrants for the company's equity

Prepetition Capital Structure

CRC entered chapter 11 with $5.24bn in funded debt including:

- $883mm RBL revolver due 2021
- $1.3bn 1.25L term loan due 2020
- $1bn 1.5L (first lien, second-out) term loan due 2021
- $1.81bn in 8% 2L notes due 2022

The company's prepetition unsecured debt included:

- $100mm in 5.5% notes due 2021
- $144mm in 6% notes due 2024



## CASE STUDY: CALIFORNIA RESOURCES CORPORATION (CONT.)

Initial RSA

On July 15, 2020, the company entered into an initial RSA (the "Initial RSA") with the ad hoc group of the 1.25L and 1.5L term loan holders, a minority of the 2L noteholders, and select lenders

The RSA contemplated a substantial deleveraging of the company's balance sheet, a significant new money investment component to better position the company upon emergence, and a settlement with certain joint venture parties

Key Terms of the Initial RSA

- $1.133 billion in aggregate DIP financing, repaid at emergence
- $[TBD] 1L Exit Facility
- Commitment for a 2L exit facility in an aggregate principal amount of $200 million provided by the 1.25L group
- $450 million equity rights offering, backstopped by the 1.25L group, with a 35% discount to plan value
- 8% backstop fee, 25% minimum allocation
- Holders of RBL claims to be paid in full
- 1.25L term loan holders would take 93% of CRC's equity and 93% of the subscription rights under the rights offering
  - Those term loan lenders' deficiency claim and holders of 1.5L (second out) term loan debt would be classified together with second lien noteholders and unsecured noteholders, receiving 7% of CRC's equity and subscription rights for 7% of the rights offering if the class voted in favor of the plan
- Unsecured creditors would be unimpaired if that class voted in favor of the plan

## CASE STUDY: CALIFORNIA RESOURCES CORPORATION (CONT.)

Amended RSA

- Following further negotiation among the ad hoc group, the company, and its prepetition creditors, the RSA was amended and restated on July 24, 2020 to include the crossover ad hoc group of 2L noteholders

Key Terms of Amended RSA

- $1.133 billion in aggregate DIP Financing
- A commitment for a 2L exit facility in an aggregate principal amount of $200 million
- A $450 million equity rights offering, backstopped by certain of the parties to the RSA; and
  - $405 million Tranche A Rights Offering offered to the 1.25L Secured Class
  - $45 million Tranche B Rights Offering offered to the Deficiency/Unsecured Class
  - Each holder of a 1.25L stipulated secured claim would receive its pro rata share of (i) 83.6% of the total new common stock in reorganized CRC (subject to dilution) and (ii) 100% of the Tranche A subscription rights
  - Each holder of a Deficiency/Unsecured Debt Claim would receive its pro rata share of (i) 16.4% of the total new common stock in Reorganized CRC (subject to dilution) and (ii) 100% of the remaining Tranche B subscription rights
  - New DIP exit fee payable in equity of 2.5% only if the plan contemplated by the RSA were consummated

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## CASE STUDY: CALIFORNIA RESOURCES CORPORATION (CONT.)

Key Terms of Amended Backstop Commitment Agreement

- In consideration for fully backstopping the rights offering for 42% of the fully diluted new common stock at a 35% discount to the $1.65 billion Plan equity value:
- Tranche A Minimum Allocation: 37.5%
  - Tranche B Minimum allocation: 50%
  - Backstop Fee: 10%
  - The Backstop Commitments and Backstop Fee were split between 1.25L holders and Deficiency/Unsecured holders based on a (non-public) schedule; because of group holdings, certain holders within the 1.25L group received a portion of the benefit being provided to the “Tranche B” holders

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## Questions

## Panel Members

Honorable Barbara J. Houser

United States Bankruptcy Judge

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# Faculty

**Hon. Barbara J. Houser** is a retired U.S. Bankruptcy Judge for the Northern District of Texas in Dallas, now serving on recall status, and she is ABI's Immediate Past President. She previously was with Locke, Purnell, Boren, Laney & Neely in Dallas and became a shareholder there in 1985. In 1988, she joined Sheinfeld, Maley & Kay, P.C. as the shareholder-in-charge of the Dallas office and remained there until she was sworn in as a U.S. Bankruptcy Judge in 2000. While at Sheinfeld, Judge Houser led the firm's representation of clients in a variety of significant national chapter 11 cases. She lectures and publishes frequently, is a past chairman of the Dallas Bar Association's Committee on Bankruptcy and Corporate Reorganization, is a member of the Dallas, Texas and American Bar Associations, and is a Fellow of the Texas and American Bar Foundations. Judge Houser served as a contributing author to *Collier on Bankruptcy* for many years and taught creditors' rights as a visiting professor at the SMU Dedman School of Law. She was elected a Fellow of the American College of Bankruptcy in 1994, and in 1996, she was elected a conferee of the National Bankruptcy Conference. In 1998, the National Law Journal named Judge Houser as one of the 50 most influential women lawyers in America. After becoming a bankruptcy judge, she joined the National Conference of Bankruptcy Judges and served as its president from 2009-10. Judge Houser has received a variety of awards and honors since taking the bench, the Distinguished Alumni Award for Judicial Service from the SMU Dedman School of Law in February 2011, ABI's Judge William Norton Jr. Judicial Excellence Award in October 2014, and the Distinguished Service Award from the Alliance of Bankruptcy Inns of the American Inns of Court in October 2016. She also received the Distinguished Service Award from the American College of Bankruptcy in October 2021. Judge Houser has served the judiciary in a number of capacities during her 21 years on the bench, including as a member of the Judicial Conference Committee on the Administration of the Bankruptcy System for seven years, as a member of the faculty that the Federal Judicial Center selected to teach new bankruptcy judges for many years, and as a member of the board of directors of the Federal Judicial Center, which is chaired by Chief Justice John Roberts. In June 2017, she was appointed to serve as the leader of a five-federal-judge mediation team tasked with settling all of the issues in dispute in connection with the historic insolvency filings by the Commonwealth of Puerto Rico and certain related instrumentalities under Title III of PROMESA. Judge Houser received her undergraduate degree with high distinction from the University of Nebraska and her J.D. from Southern Methodist University Law School, where she was editor of its law review.

**Mark B. Joachim** is a shareholder with Polsinelli in Washington, D.C., where he focuses on acquisition, recapitalization and other leveraged financings; rescue financings; cash-flow and asset-based financings; debtor-in-possession, exit and cross-border financings; multitranche, unitranche and mezzanine financings; and restructurings, workouts and bankruptcies. He has more than 25 years of experience representing clients on complex financing arrangements. In the restructuring arena, Mr. Joachim regularly represents distressed businesses, boards of directors, special committees, independent directors, debtor-in-possession lenders, distressed-debt investors, official committees, and ad hoc groups of creditors in connection with bankruptcy proceedings and out-of-court restructurings. His background includes representing first- and second-lien senior lenders, mezzanine investors, and equity sponsors and borrowers in senior debt, mezzanine and private-equity financing arrangements. He has successfully closed dozens of leveraged finance transactions for lenders utilizing cash-flow, asset-based and hybrid structures. Mr. Joachim is a member of the Turnaround Management Association and is an associate editor of the *ABI Journal*. He received his B.A. in 1989 in political science and philosophy from Stony Brook University and his J.D. in 1992 with distinction from Hofstra University School of Law, where he is managing editor of the *Hofstra Law Review*.

**Angela M. Libby** is a restructuring partner with Davis Polk & Wardwell LLP in New York, where she advises debtors, creditors, banks, hedge funds, lenders, asset-purchasers and other strategic parties in a wide range of corporate restructuring matters, including prepackaged and traditional bankruptcies, out-of-court workouts, debtor-in-possession and exit financing transactions, asset sales, bankruptcy litigation, cross-border insolvencies and liability-management transactions. A 2019 ABI "40 Under 40" honoree, Ms. Libby was named a 2021 "Rising Star" in energy by *Law360*, and *Turnarounds & Workouts* listed her among 2020's "Outstanding Young Restructuring Lawyers." In addition, she was one of only three recipients nationwide of the 2019 *IFLR* "US Rising Star Award" and was featured in *Global Restructuring Review*'s inaugural "Women in Restructuring" report. Ms. Libby received her A.B. in history and religion from Dartmouth College and her J.D. from New York University School of Law, where she was an AnBryce Scholar.

**William L. Wallander** is a partner and practice group leader of the Restructuring & Reorganization Practice Group of Vinson & Elkins LLP in Dallas, and he has more than 20 years of experience in complex restructuring and reorganizations across a broad spectrum of clients and industry lines. He represents debtors, agents and lending groups, bondholder and noteholder groups, funds and committees, and has also served as an expert witness in bankruptcy court in connection with class-action securities litigation. His industry experience includes aerospace, agriculture, chemicals, commodities, construction, defense, energy (upstream, midstream, downstream, renewables), derivatives, financial services, health care, hotel, legal, manufacturing, mining, mortgage finance, power, public finance, commercial real estate, retail, shipping, technology and transportation. Mr. Wallander is a member of the American Bar Association, the State Bar of Texas's Bankruptcy Section (for which he serves as chair-elect), the New York Bar Association and the Dallas Bar Association's Bankruptcy and Commercial Law Section, ABI, the Texas Bank Association, the Texas Bar College and the Turnaround Management Association. He is a Fellow in the American College of Bankruptcy, a Life Fellow of the Dallas Bar Foundation, and a member of the Chancellor's Council and Littlefield Society of the University of Texas. Mr. Wallander is admitted to practice before the U.S. Supreme Court, the Texas Supreme Court, the Supreme Court of the State of New York, the U.S. Courts of Appeals for the Fifth and Tenth Circuits, and the U.S. District Courts for the Northern, Eastern, Western and Southern Districts of Texas and the District of Arizona. He has been listed in *Chambers Global*, *Chambers USA*, *The Best Lawyers in America*, *Texas Super Lawyers*, *Euromoney* and *Who's Who Legal in Texas* for insolvency and reorganization law. Mr. Wallander received his B.A. *magna cum laude* in political science and economics from the University of Pittsburgh in 1981, his J.D. from the University of Texas School of Law in 1984 and his M.B.A. *summa cum laude* from the University of Phoenix in 2001.

**Jonathan W. Young** is a partner with Locke Lord LLP in Boston and co-chairs the firm's Bankruptcy, Restructuring and Insolvency Practice Group. He regularly advises investors, lenders, directors, equity sponsors and portfolio companies in connection with their rights and obligations relative to financial distress, insolvency and bankruptcy situations. He also advises trustees, receivers and other fiduciaries charged with reorganizing, restructuring or liquidating financially distressed entities. Mr. Young handles a wide range of complex commercial litigation matters — at both the trial and appellate level — with a particular focus on insolvency, bankruptcy and secured lending issues. While he has handled engagements in a wide range of industries, he has experience in private equity, advertising and media, technology and telecommunications, life sciences, audit and accounting and insurance. Mr. Young served as a member of the firm's Executive Committee from 2014-16. He is admitted to practice before the U.S. Supreme Court and the U.S. Courts of Appeals for the First, Second, Third and Sixth Circuits. Mr. Young has been listed in *Chambers USA* for Restructuring and Insolvency since 2013, *The Best Lawyers in America* for Bankruptcy and Creditor Debtor Rights/ Insolvency and Reorganization Law since 2021, *Global Restructuring Review 100* since 2019, and *Illinois Super Lawyers* for Bankruptcy since 2009. He received his B.A. *cum laude* in 1986 from Yale University and his J.D. in 1990 from Northwestern University School of Law.