Southeast Bankruptcy Workshop

Top Issues for Public Company Bankruptcies

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CONCURRENT SESSION

2023

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Moderator

Jim is the Managing Partner of the Louisville office and co-chair of the Restructuring, Insolvency and Bankruptcy practice in the United States. Jim has experience representing debtors, creditors ' committees, foreign representatives in Chapter 15 bankruptcy cases, liquidating trustees, and parties acquiring assets in distressed situations.

Jim is a director of the American Bankruptcy Institute and was a recipient of the American Bankruptcy Institute's inaugural 40 Under 40 Award in 2017. Jim was named one of *Louisville Business First*'s Forty Under 40 in 2019. He was selected for the National Conference of Bankruptcy Judges Next Generation Program in 2018. Jim was also the recipient of the Chicago Bar Association's Exceptional Young Lawyer Award in 2013. His experience with matters of juvenile justice through his pro bono work has led to opportunities to teach CLEs and edit publications on the subject for the American Bar Association.

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To Sean Beach any corporate restructuring situation is an opportunity to dive deeply, and usually quickly, into the inner workings of a business and the concerns of its key stakeholders. Each industry poses its own set of challenges, and the various companies within that industry present both broad contrasts and subtle nuances, all of which must be absorbed in the course of a well-thought-out restructuring. He has steered distressed companies and their creditors to optimal outcomes in a wide range of industries, including energy, retail, mortgage lending and servicing, healthcare, manufacturing and technology.

He knows well the pressures facing directors and officers — whether on the debtor or creditor side — and his clients rely on him to help manage those issues while navigating the strategic and tactical complexities of a time-sensitive restructuring, in or out of bankruptcy. In an environment of multiple competing interests, he is known for being as aggressive or as flexible as the situation calls for, and for arriving at the best available litigated result or deal for his clients. As lead counsel or co-counsel, primarily in Delaware and New York, this versatility proves a valuable strategic resource for his clients, many of whom are facing a potential bankruptcy for the first time.

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Katie Goodman has a strong background in finance, operations, and mergers and acquisitions. She often assumes the role of director of reorganization or restructuring officer for companies with private equity funding, and she serves as an adviser to boards of directors and management teams. Ms. Goodman joined GGG Partners, LLC (formerly Grisanti, Galef & Goldress), one of the oldest turnaround consulting firms in the United States, in 2001. Since then, she has worked with many public and private companies, focusing in particular on firms in the middle market. Ms. Goodman quickly assesses a company's situation, determines a course of corrective action that is tailored to each client's needs, and executes the plan. She is known for both her candor and her results-oriented approach.

Ms. Goodman has worked in various industries, including textiles, telecommunications, retail, commercial and residential contracting, millworks, commercial distribution, publishing, government contracting, business-to-business distribution and consumer products companies.

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Gary is a veteran restructuring attorney focused on all aspects of bankruptcy, workouts, debtor and creditor law, and general commercial litigation. He represents debtors and creditors in Chapter 11 cases, out-of-court restructurings and litigation. He also represents court appointed receivers, examiners and trustees. Gary's practice primarily involves representing financial institutions and servicers in and out of court in enforcing their rights and remedies. He also analyzes and defends against preference and fraudulent conveyance actions, represents buyers of assets out of bankruptcy and represents landlords and other parties who have leases or contracts with debtors. Gary has deep industry experience particularly with health care, energy, and real estate insolvencies. He also acts as a mediator and arbitrator in cases involving any type of dispute.

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Matthew L. Warren

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Matthew Warren is a finance partner in King & Spalding's Chicago office, advising clients on restructuring matters with a particular emphasis on distressed debt and insolvency issues.

Mr. Warren represents lenders and bondholders, as well as companies, in connection with restructuring and insolvency related matters. Mr. Warren advises lenders and bondholders in maximizing recoverable value and helps distressed companies navigate through difficult circumstances based on a sophisticated sense of market practice and extensive experience with complex and challenging scenarios.

Mr. Warren was named to the American Bankruptcy Institute's 2019 "40 Under 40" Emerging Leaders in Insolvency List. He was also recognized for his work in Bankruptcy and Restructuring by Chambers USA 2019 and Turnarounds & Workouts named him a 2018 Outstanding Young Restructuring Lawyer.

Mr. Warren is a member of the American Bankruptcy Institute and teaches as an adjunct professor of Bankruptcy Law at the DePaul College of Law. He regularly speaks and writes on bankruptcy topics.

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Relevance of Public Company Bankruptcy Today

What is the Current Market Distress and Is It Unique to Public Companies?

- The Headwinds:
  - ➢Rising Interest Rates
  - ➢Contracting Equity and Debt Markets to Raise Capital
  - ➢Pandemic Relief Has Abated
  - ➢Global Issues Continue to Impact Supply Chain

- Impact Both Public and Private Companies
  - ➢But, Public Companies – Particularly DeSPACs – May Be Prominent This Cycle
  - ➢Chart Below - Quarterly Filing Trends For Companies With Over $100m Of Assets/Liabilities

Figure 1: Key Trends in Bankruptcy Filings
2005–1H 2022

	2005–2021 Annual Average	1H 2021	2H 2021	1H 2022
Chapter 11 Bankruptcy Filings	75	43	27	20
Chapter 11 Mega Bankruptcies	22	9	11	4
Chapter 11 Bankruptcy Filings by Public Companies	44	9	7	8
Chapter 11 Bankruptcy Filings by Private Companies	31	34	20	12
Chapter 7 Bankruptcy Filings	3	0	0	0
Average Asset Value at Time of Filing (Billions)	$2.08	$0.62	$0.59	$1.04

Source: BankruptcyData

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Why is This Relevant Now?

- SPACs (Special Purpose Acquisition Company)
  - ➢What are they and how do they work?
  - ➢Are SPACs the bellwether for this wave of public company bankruptcy filings?

Aspects of Public Companies That Make Impact The Decision to File Bankruptcy

Pre-Bankruptcy Distressed Debt Exchanges in Public Companies

What is a Distressed Debt Exchange?

- The term distressed debt exchange (DDE) itself continues to evolve and, broadly speaking, includes any exchange of loans or notes at a discount to par value.
- Often in DDE existing debt holders take a haircut in exchange for moving up in payment priority by obtaining secured debt and/or obtaining equity securities as additional consideration for debt or debt relief
- Generally, a distressed exchange is undertaken by a company to avoid a bankruptcy, improve liquidity, reduce debt, manage its maturity dates and/or to reduce or eliminate restrictive covenants
- Upon the completion of a DDE, the company's goal is generally to have reduced its total debt and interest expense without using cash, thereby improving its credit profile and permitting it an opportunity to turn the corner and avoid further restructuring and enhance shareholder value

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Understanding Out of Court Distressed Debt Exchanges From the Company's Perspective

Why Companies Pursue DDEs

- Deleveraging as a strategic tool
- Manage upcoming debt maturity schedule
- Create accounting gains
- For convertible debt, improve EPS
- Alternative to more fundamental restructuring or potential bankruptcy
- Amend and/or eliminate restrictive covenants

Structuring Considerations

- Business objectives and financial condition
- Legal / accounting / tax impacts
- Credit ratings impacts
- Public disclosure of repurchase plans (MD&A)
- Stock exchange rules (20% rule requiring stockholder approval) if dealing with convertible debt/equity
- Covenants in existing debt securities and credit facilities
  - Required repayment / prepayment of existing debt
  - Specific use of proceeds for cash on hand, asset sales or capital raising activity

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Understanding Out of Court Distressed Debt Exchanges From the Investor's Perspective

Pros	Cons
• Higher interest rates • Additional (or senior) security • There may be an option for immediate cash • Resets the strike price on convertible debt, warrants or equity • Potentially provides the company with runway to deleverage and avoid bankruptcy	• Extended maturities • May be asked to forgive a portion of existing debt • Company's credit ratings can be negatively impacted if DDEs are considered a technical default • Bond recovery rates tend to be lower if there is a subsequent bankruptcy

- An analysis conducted by Moody's found that in 218 distressed exchanges from 1990-2013, companies that executed distressed exchanges were more likely than not to avoid subsequent default during the following three years. However, these bond recovery rates tended to be lower if there was a subsequent bankruptcy.

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Summary of Securities Transaction Structures

	Privately Negotiated / Open Market	Cash Tender Offer	Registered Exchange Offer	Section 3(a)(9) Exchange Offer	Section 4(a)(2) Exchange Offer	Pre-pack
Available for use with all holders	No	Yes	Yes	Yes	No, unless all are AIs / QIBs	Yes
Cash required	Yes	Yes	No	No	No	No
Bankers may actively solicit	Yes, limited number	Yes	Yes	No	Yes	Yes
Securities of affiliates available for exchange	Not applicable	Not applicable	Yes	No(1)	Yes	Yes
Holdout risk	Not applicable	Yes(2)	Yes(2)	Yes(2)	Yes(2)	No
Status of any new securities	Not applicable	Not applicable	Freely tradeable	Depends	Restricted	Depends
Timing	Quick	1 month +	6 weeks +(3)	Quick to 1 month +	Quick to 1 month +	Varies
Transaction costs	Minimal	Low	High	Moderate	Moderate	High

(1) Except as otherwise permitted by SEC guidance deeming securities of affiliates to be securities of the same "issuer"
(2) Holdout risk can be mitigated by coupling with a consent solicitation
(3) Offer may commence while awaiting effectiveness, but extensions may be necessary to address SEC comments

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Consent Solicitations for Note Securities

- *Why do a consent solicitation?*
  - Amend restrictive covenants to permit a potential transaction or additional business operations
  - Modify indenture covenants that restrict or prohibit a restructuring of other debt in order to preserve "going concern" value and avoid bankruptcy
- Amendments to debt securities are obtained through consent solicitations
  - Trust Indenture Act and most indentures prohibit amendments that reduce principal or interest, amend the maturity date, change the form of payment or make other economic changes
  - Significant changes can also call into question the SEC's "New Security Doctrine" resulting in de factor exchange offer
- Consent solicitations can be coupled with tender offers and exchange offers or can be done on a stand-alone basis
- Approval and documentation requirements are governed by relevant indenture provisions
- Typically held open for 10 business days when done in isolation
- Subject only to contract law principles unless done in connection with tender offer or exchange offer

Benefits	Disadvantages
• May be undertaken alone or in combination with liability mgmt. activities • Can modify onerous covenants • Not subject to SEC review or tender rules when done in isolation	• May require supermajority approval • Trust Indenture Act prohibits certain modifications • Some modifications may result in a "new security" being deemed to be issued • Tax implications

Considerations with granting consents

- Holders may be unwilling to consent to significant modifications because they will still hold the securities afterward
- Exit consents are used to change significantly restrictive provisions in connection with a tender or exchange offer
  - Given by tendering or exchanging holders (who are about to give up their securities) and bind non-tendering or non-exchanging holders
  - Act as a useful incentive to avoid the "holdout" problem because non-tendering and non-exchanging holders are left with securities that have lost most, if not all, of their protections.
- An issuer may also include a "consent payment" to consenting holders as part of the consideration

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Noteholder Sacred Rights

Note Indentures typically include significantly fewer "sacred rights" than a typical Credit Agreement, which are generally limited to:

- Waiving payment or modifying interest rates
- Extension of Maturity

The structure of traded notes – common for public companies - makes broader sacred rights typically impractical due to, among other things:

- Limited ability for the Issuer to identify beneficial holders of notes and, as a result, challenges in identifying parties to negotiate transactions absent holders willingly self-identifying and engaging
- Noteholders typically more sensitive to receipt of MNPI, leading to more limited term wall-crossing for straightforward transactions or reliance on advisors as MNPI intermediaries
  - Lenders may also be sensitive to receipt MNPI, particularly in the context of a publicly traded company, but to date the SEC has not treated syndicated loans as securities meaning trading of syndicated loans on "big boy" letters is more often engaged in with respect to trading syndicated loan position even if one holder has confidential information
- Generally, a majority of noteholders can direct the indenture trustee and the collateral trustee; a lower threshold may be able to direct acceleration of all notes following default

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The Role of Ad Hoc Groups in Public Companies

Liability management transactions and DDE's may be pursued by a Company as a standalone technique that is pushed to the market as a proposed final package or pre-negotiated with an Ad Hoc Group comprised of a sub-set creditors so that when taken to the broader group of lenders or noteholders it is in a negotiated format and guaranteed a degree of support.

What is an Ad Hoc Group?

- Group of lender or noteholders who agree to organize and act collectively
- Almost always hire separate counsel and may also hire financial advisors
- Ad Hoc Group's may comprise "required lenders" under a credit agreement or "required noteholders" – but, particularly in the context of widely held structures, may consist of a smaller percentage that is still sufficient to drive a negotiation with the Company

Key points to address at formation of Ad Hoc Group and throughout existing of the Ad Hoc Group

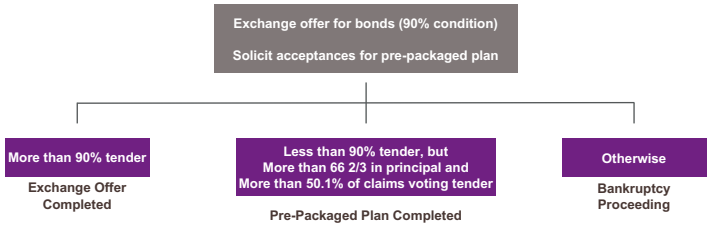
- Beneficial ownership thresholds must be assessed at the outset of group formation and through the period in which the creditors are acting as a group. Acting as a group may trigger reporting obligations under Section 13 and/or Section 16 of the Securities Exchange Act if certain equity thresholds are exceeded (note: convertible debt holdings ***may*** be treated as equity for this purpose depending on the terms of the documentation and status of the issuer)
- The structure of how an Ad Hoc Group will make determinations as a group is often set forth in an engagement letter with counsel for the Ad Hoc Group
- In the event of a bankruptcy filing by the Company, the Ad Hoc Group will have to make additional disclosures under Bankruptcy Rule 2019 regarding the identity of the holders and the amount of their respective debt holdings

Bankruptcy Plans as a Pre-Bankruptcy Stick

- Bankruptcy Code allows a plan of reorganization to be approved before a Chapter 11 filing by:
  - 2/3 in amount of each class of claims, and
  - more than 50% in number each class of claims
- Court would then approve plan after the bankruptcy filing
- Overrides contractual provisions and Trust Indenture Act requirements for each holder to consent to amendments impacting payment terms
- Also allows for "cram down" on junior creditors where at least one class of senior claims has approved the plan
- Securities issued in an approved plan are generally freely tradeable

Benefits	Disadvantages
• Eliminates holdout problem • Securities issued pursuant to plan are freely tradeable	• More expensive and disruptive than non-bankruptcy alternatives • Requires 2/3 in amount and 50.1% in number of claims voting to consent • Marketplace stigma

- Can be combined with exchange offers
- This is the "biggest stick" one can swing short of a simple bankruptcy filing (*i.e.*, without pre-approval of a plan)
- In a combined offer a vote for the exchange offer would also be a vote for the bankruptcy plan



Shareholder Votes

A key consideration in addressing any situation for a public company – particularly a distress situation – is the requirement of a shareholder vote. Common situations include:

- Merger or consolidation with another entity
- Sale of all or substantially all assets
- Charter amendments, such as to increase or authorize additional capital stock or change stockholder rights
- Reverse stock splits
- Change in control under applicable stock exchange rules
- Issuance of 20% or more of its outstanding shares or voting power
- Certain issuances to directors, officers and substantial security holders
- Adopt equity incentive plans

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DGCL 271

§ 271. Sale, lease or exchange of assets; consideration; procedure.

(a) Every corporation may at any meeting of its board of directors or governing body sell, lease or exchange all or substantially all of its property and assets, including its goodwill and its corporate franchises, upon such terms and conditions and for such consideration, which may consist in whole or in part of money or other property, including shares of stock in, and/or other securities of, any other corporation or corporations, as its board of directors or governing body deems expedient and for the best interests of the corporation, ***when and as authorized by a resolution adopted by the holders of a majority of the outstanding stock of the corporation entitled to vote thereon*** or, if the corporation is a nonstock corporation, by a majority of the members having the right to vote for the election of the members of the governing body and any other members entitled to vote thereon under the certificate of incorporation or the bylaws of such corporation, at a meeting duly called upon at least 20 days' notice. The notice of the meeting shall state that such a resolution will be considered.

…

(c) For purposes of this section only, ***the property and assets of the corporation include the property and assets of any subsidiary of the corporation***. As used in this subsection, "subsidiary" means any entity wholly-owned and controlled, directly or indirectly, by the corporation and includes, without limitation, corporations, partnerships, limited partnerships, limited liability partnerships, limited liability companies, and/or statutory trusts. Notwithstanding subsection (a) of this section, except to the extent the certificate of incorporation otherwise provides, no resolution by stockholders or members shall be required for a sale, lease or exchange of property and assets of the corporation to a subsidiary.

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Proposed DGCL 272

(b) Without limiting the rights of a secured party under applicable law, no resolution by stockholders shall be required by § 271(a) of this title for a sale, lease or exchange of property or assets if such property or assets are collateral that secures a mortgage or are pledged to a secured party and either:

(1) The secured party exercises its rights under the law governing such mortgage or pledge or other applicable law, whether under Article 9 of a Uniform Commercial Code, a real property law or other law, to effect such sale, lease or exchange without the consent of the corporation; or

(2) In lieu of the secured party exercising such rights, the board of directors of the corporation authorizes an alternative sale, lease or exchange of such property or assets, whether with the secured party or with another person, that results in the reduction or elimination of the total liabilities or obligations secured by such property or assets, provided that (i) the value of such property or assets is less than or equal to the total amount of such liabilities or obligations being eliminated or reduced and (ii) such sale, lease or exchange is not prohibited by the law governing such mortgage or pledge. The provision of consideration to the corporation or to its stockholders shall not create a presumption that the value of such property or assets is greater than the total amount of such liabilities or obligations being eliminated or reduced.

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Proposed DGCL 272 (cont.)

(c) A failure to satisfy the proviso in subsection (b)(2)(i) of this section shall not result in the invalidation of a sale, lease or exchange if the transferee of the property or assets provided value therefor (which may include the reduction or elimination of the total liabilities or obligations secured by such property or assets) and acted in good faith (as defined in § 1-201(b)(20) of Title 6). The preceding sentence shall not apply to a proceeding against the corporation and any other necessary parties to enjoin such sale, lease or exchange before the consummation thereof and shall not eliminate any liability for monetary damages for any claim, including a claim in the right of the corporation, based upon a violation of fiduciary duty by a current or former director or officer or stockholder.

(d) A provision of the certificate of incorporation that requires the authorization or consent of stockholders for a sale, lease or exchange of property or assets shall not apply to a transaction permitted by subsection (b) of this section unless such provision expressly so requires; provided that this subsection (d) shall apply only to certificate of incorporation provisions that first become effective on or after August 1, 2023.

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Challenges Caused by Securities

Notice Procedures

Motion for Notification Procedures

How do you get notice to holders of securities?

- Filing of notice procedures motion
  - Within the motion for notification procedures the debtors seek entry of orders approving certain notification and hearing procedures
  - The motion will contain an Exhibit that outlines the specific notification procedures that will be applied, which may include details on:
    - The timeline for serving notice
    - The individuals responsible for serve the Notice of Interim Order or Notice of Final Order
    - And the treatment of confidential information required in declarations
  - The motion may impose limitations on trading securities during the pendency of the case

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Things to Consider

Good Governance:

- Minimizes the potential for corruption
- Increases inclusion and the ability to benefit from diverse thinking
- Reacts to the needs of society, both now and in the future

Principles of Good governance:

- Accountability
- Transparency
- Fairness
- Responsibility
- Risk management

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Dealing with SEC Disclosures in Public Company Bankruptcies

Why are Disclosures Necessary? Brief Overview of Required SEC Forms

The Securities Exchange Act ("Exchange Act"), passed by Congress in 1934, requires publicly traded companies to file certain reports with the Securities and Exchange Commission ("SEC").

Form 10-K	Form 10-Q	Form 8-K
Form 10-K is filed annually and requires public companies to provide an overview of their business and financial conditions, including audited financial statements.	Form 10-Q is filed quarterly and requires that the company update their positions throughout the fiscal year and includes unaudited financial statements.	Form 8-K is required to be filed upon the occurrence of "material events" which affect the company.

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Introduction: Summary of Key Points

The "Base Case" – Most public companies undergoing a Chapter 11 restructuring must continue to file and comply with all requirements imposed by the SEC.

- However, in rare situations, public companies may seek relief from the SEC's reporting requirements and instead engage in what is called "modified reporting." The conditions required to qualify for modified reporting are difficult to satisfy and companies are often not able to meet them.

After a Chapter 11 restructuring has concluded, public companies generally have two choices regarding reporting requirements.

- (1) Report and Re-List – A public company can elect to continue their required reporting obligations and, potentially, re-list their securities on a national exchange.
- (2) "Going Dark" – A public company can elect to emerge from bankruptcy as a private company, if certain requirements are satisfied.

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Disclosure Considerations: Before Filing the Chapter 11 Petition

Prior to filing the Chapter 11 petition, reporting requirements remain ongoing as if in the normal course.

However, if in advance of a potential restructuring, there are changing financial and business conditions, filing an updated Form 8-K may be necessary.

Pre-Petition Events That May Trigger Form 8-K
(1) Withholding principal or interest payments, or other material defaults
(2) Entering into, extending, amending, or terminating a forbearance agreement
(3) Material impairments
(4) Entering into or amending a key employee incentive program
(5) Failing to satisfy a continued listing rule
(6) Temporary suspension of trading under employee benefit plans
(7) Cleansing debt-holders under a Non-Disclosure Agreement ("NDA")

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Lender NDAs and "Cleansing" Clauses

Prior to filing the Chapter 11 petition, it is likely that a public company will engage in negotiations with creditors. During these negotiations, it is not uncommon for the company and its attorneys to require lenders to sign what are called "restructuring NDAs."

"**Restructuring NDAs"** – Require the creditor(s) to acknowledge that they may receive material non-public information ("MNPI") during the negotiation process and restrict the buying and selling of the company's securities while the creditor(s) have possession of the MNPI.

"Cleansing Clauses" – Most restructuring NDAs contain "cleansing clauses." Cleansing clauses require the company to "cleanse" any MNPI disclosed during negotiations by publicly releasing the information via a Form 8-K or press release.

- This allows companies to be able to share highly sensitive information that may be necessary to get creditors to the negotiating table while simultaneously ensuring that creditors are not bound by infinite trading restrictions.

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Disclosure Considerations: Filing the Chapter 11 Petition

Typically, upon the filing of the Chapter 11 petition, a company will be required to concurrently file a Form 8-K. The form will disclose the type of restructuring.

Once the company has filed their Form 8-K, the securities exchange may elect to immediately suspend trading in the company's securities depending on the facts.

(1) Prompt De-Listing – Securities may be immediately de-listed where: (a) A company has announced publicly that (i) there is no expected recovery to the equity securities or (ii) that the listed securities are likely to be canceled through the restructuring; and (b) The securities exchange has determined that the company is not expected to meet the exchange's continued listing standards.
(2) Delayed De-Listing – The de-listing of securities may be delayed where the restructuring outcome for the exchange-listed securities is unclear.
(3) No De-Listing – De-listing may not occur at all if recovery for the exchange-listed securities is expected from the outset of the proceeding and the plan is almost certain to be confirmed.

Note **– The two major financial securities markets in the United States are (1) the New York Stock Exchange and (2) Nasdaq. In addition, stocks may also be exchanged via a smaller, more regional exchange or an Over-the-Counter ("OTC") market. An OTC market is a market where securities are traded through a broker-dealer network. It is not centralized and occurs between two parties.**

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Disclosure Considerations: During the Chapter 11 Proceedings

The "Base Case" – In most cases of a public company undergoing a Chapter 11 proceeding, it is expected that the company will be required to continue its typical SEC filings uninterrupted.

- However, additional Form 8-K filings may be triggered as a result of events that occur during the Chapter 11 proceeding. These events include things such as (a) asset sales outside of the ordinary course of business under §363 or (b) debtor-in-possession ("DIP") financing agreements.
- Companies also typically file monthly reporting reports required by the bankruptcy court.

Modified Reporting – Although uncommon, there are certain rare conditions under which the SEC will permit companies to comply with a modified reporting schedule during restructuring. The SEC's key consideration is whether "the benefits that might be derived by shareholders of the debtor from the filing of the information are outweighed significantly by the cost to the debtor of obtaining the information."

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Implications for Failing to Comply with SEC Disclosure Requirements During Restructuring

Failure to comply with SEC disclosure requirements, even during restructuring, can result in running afoul of the Exchange Act and limit a company's ability to sell and trade stock.

- A temporary suspension of trading under Section 12(k) of the Exchange Act can occur for minor violations. However, in more extreme cases, such as a continued failure to comply, a revocation under Section 12(j) of the Exchange Act can result in an indefinite end to all public trading in a company's stock.

Moreover, depending on the situation, non-compliance with disclosure requirements can lead to civil and criminal penalties for the company and/or its executives.

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Disclosure Considerations: Emerging from the Chapter 11 Proceeding

Upon emerging from a Chapter 11 proceeding, a company has the choice of

- (a) Maintaining SEC reporting obligations and potentially re-listing their securities (report and re-list); or
- (b) Stopping SEC reporting and becoming private ("going dark").

Option 1: Report and Re-List – In order to report and re-list, the emerging company will need to file a Form 8-K to assume the pre-bankruptcy registration status. In addition, the company will need to satisfy all listing procedures set out by the securities exchange.

- The earliest that a company can attempt to re-list their securities is the date after the notice of an effective date for a confirmed re-organization plan.

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Requirements for "Going Dark": Forms 25 & 15

Option 2:"Going Dark" – In order to successfully "go dark" and become private, there are three obligations under the Exchange Act that a public company must terminate. Accordingly, a company is required to do the following:

(1) De-list all securities from any national securities exchanges (§12(b))
(2) Ensure that the number of outstanding holders of record is below 2,000 (§12(g))
(3) Not have sold or issued any securities pursuant to an effective registration statement in the last fiscal year (§15(d))

A company can successfully terminate these obligations by filing a Form 25 and a Form 15 with the SEC.

Form 25	Form 15
The voluntary filing of a Form 25 will de-list all securities from any national exchange within 10 calendar days, eliminating obligations under §12(b) in approximately 90 days.	Filing a Form 15 will allow a company to effectively eliminate their obligations under §12(g) and §15(d).

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Equity Committees

Appointment of Equity Committees

What does the Code say?

- If the United States Trustee declines to appoint an official equity committee, § 1102(a)(1) of the Bankruptcy Code allows a party in interest to request that the bankruptcy court order the appointment of an equity committee.
- 11 U.S.C. § 1102(a)(2) : On request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee.

What are the standards for appointment?

- The cost associated with the appointment
- The time of the application
- The potential for added complexity
- The presence of other avenues for creditor participation

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Net Operating Losses (NOLs) in Public Company Bankruptcies

What are NOLs and Why are They Relevant? Introduction and Key Points

Net Operating Loss ("NOL") – An NOL is incurred when tax-deductible expenses exceed taxable revenue.

Although NOLs are often overlooked when valuing a company in bankruptcy, they nonetheless can constitute a significant asset of the bankruptcy estate.

- The Internal Revenue Service ("IRS") generally permits publicly traded companies to carry over NOLs to offset future taxable income and to reduce their tax liability in future periods, including during the pendency of the Chapter 11 case (*See* §172 of the Internal Revenue Code).
- Moreover, these savings can enhance the company's cash position for the benefit of relative parties-in-interest, such as creditors.

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Overview: The Application of NOLs to Public Company Bankruptcy

Property of the Bankruptcy Estate (§541)

- Courts have consistently held that NOLs can constitute an asset of a debtor's bankruptcy estate.

Subject to the Automatic Stay (§362)

- Similarly, courts have also found that, as an asset of the bankruptcy estate, NOLs can be subject to the automatic stay.

> "Including NOL carryforwards as property of a corporate debtor's estate is consistent with Congress' intention to 'bring anything of value that the debtors have into the estate.' Moreover … [i]ncluding the right to a NOL carryforward as property of [the debtor's] bankruptcy estate furthers the purpose of facilitating the reorganization of [the debtor]."
>
> *Official Comm. of Unsecured Creditors v. PSS Steamship Co.*, 928 F.2d 565, 573 (2d Cir. 1991) (internal citations omitted).

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Statutory Limitations: §382 of the Internal Revenue Code

However, despite the general ability of public companies to utilize the tax attributes resulting from NOLs, there are certain statutory limitations.

- §382 of the Internal Revenue Code places limits on a public company's ability to use its tax attributes to offset future income or tax liability where that entity has undergone an "ownership change."

§382	
What is an "Ownership Change?"	**What is the Effect?**
An "ownership change" occurs, within the meaning of §382, when the percentage of a corporation's equity held by its "5 percent shareholders" increases by more than 50 percentage points above the lowest percentage of ownership owned by such shareholder(s) at any time during the relevant testing period.	When implicated, §382 generally imposes a limitation on the amount of NOLs and certain other tax attributes that can be utilized to offset income. This limitation is generally equal to the product of (a) the equity value of the debtor immediately before the change in ownership multiplied by (b) a long-term tax-exempt rate.

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The Valuation of NOLs During Restructuring: Stock Trading

As discussed, where a public company experiences an "ownership change," as defined by §382, the entity may experience a loss in the benefit of their NOLs.

- However, while an "ownership change" under §382 can affect the restructuring, the trading of stock more generally can also impact the bankruptcy proceeding.

Thus, the purchase, sale, or issuance of too many shares of equity securities during restructuring, even in the normal course of business, can result in a decline in the value of a debtor's NOLs.

- Accordingly, although potentially an asset of the debtor's bankruptcy estate, the value of a company's NOLs could decline during the pendency of the proceeding if trading is allowed to occur.

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What Remedies Exist During Bankruptcy to Prevent Decline in Valuation?

As NOLs are considered part of the bankruptcy estate, public company debtors can seek to enforce the automatic stay under §362 of the Bankruptcy Code in order to prevent adverse trading prior to plan confirmation.

Potential Court-Ordered Relief
Requiring that notice of the proposed transaction(s) be served upon: (a) the debtor, (b) the debtor's attorney(s), and (c) the attorney for the creditor's committee (if one is appointed). • The relevant parties may then elect to provide written approval of the transaction, allowing it to proceed.
The court may also designate itself as the final entity to approve or deny any given transaction(s).

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The Valuation of NOLs After Restructuring

§382(1)(5) of the Internal Revenue Code exempts debtors that undergo an "ownership change" as the result of the consummation of a Chapter 11 plan from the limitations imposed by §382.

When does the Exemption Apply?
(1) If the plan provides that the person(s)/entities that owned the debtor's stock before bankruptcy emerge from the reorganization owning at least 50% of the total value and voting power of the debtor's stock; and/or
(2) If the plan provides that "qualified creditors" emerge from the reorganization owning at least 50% of the total value and voting power of the debtor's stock. "Qualified Creditors" – Creditors who (a) have held their claims continuously for at least 18 months prior to the filing of the Chapter 11 petition or (b) hold claims incurred in the ordinary course of the debtor's business and held those claims continuously since they were incurred.

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In re FedNat Holding Company (Bankr. S.D. Fla. 2022)

A recent example of an NOL Motion and Order in a Chapter 11 proceeding occurs in the case of *In re FedNat Holding Company* (Bankr. S.D. Fla. 2022).

- Here, the debtor moved to restrict transfers of the debtor's stock in order to prevent the loss of "valuable tax benefits" resulting from the company's NOLs.

Debtor's Motion Pursuant to 11 U.S.C. §§ 362 & 105(a)

- The debtor argued, among other things, that without a restriction on certain transfers of stock, an "ownership change" would be likely to occur and §382 of the Internal Revenue Code would be implicated. Thus, the automatic stay would be violated, and the debtor would be unable to take advantage of the ability to offset future income or tax liability.

Final Trading Order Approving Restrictions on Certain Transfers

- In response, the Court granted debtor's motion on first an interim and then on a final basis, finding that the failure to do so could "severely limit" the debtor's ability to preserve and use the NOL tax attributes.

Faculty

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