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Prepackaged and Prenegotiated Chapter 11 Reorganizations: Debtor and Creditor Strategies

Restructuring Support Agreements, Valuation, Credit Bidding, and More

WEDNESDAY, JUNE 23, 2021

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Prepackaged and Prenegotiated Chapter 11 Reorganizations: Debtor and Creditor Strategies

June 23, 2021

Presented by Van Durrer and Sunny Singh

AGENDA

1. Introduction
2. Comparison of Types of Chapter 11 Cases
3. Out-of-Court Liability Management Strategies
4. Prepackaged Cases
5. *Roust* Case Study
6. *Belk* Case Study
7. *Secure Home* Case Study
8. Pre-negotiated Cases
9. *McClatchy* Case Study
10. *Exide* Case Study
11. Securities Law Hurdles

Introduction

TYPES OF CHAPTER 11 CASES

- Pre-packaged
- Pre-negotiated
- Conventional
- Liquidating

Major Reasons Motivating the Filing

- Loss of Liquidity

Strategic:

- Balance Sheet De-leveraging
- Mitigation of Contingent Liabilities
- Strategic Operating Restructuring
- Transactional

TRADITIONAL CHAPTER 11 CASES

- If out-of-court options are unavailable, or if the debtor would benefit from the tools available to debtors under the Bankruptcy Code, a chapter 11 filing may be in the issuer's best interests

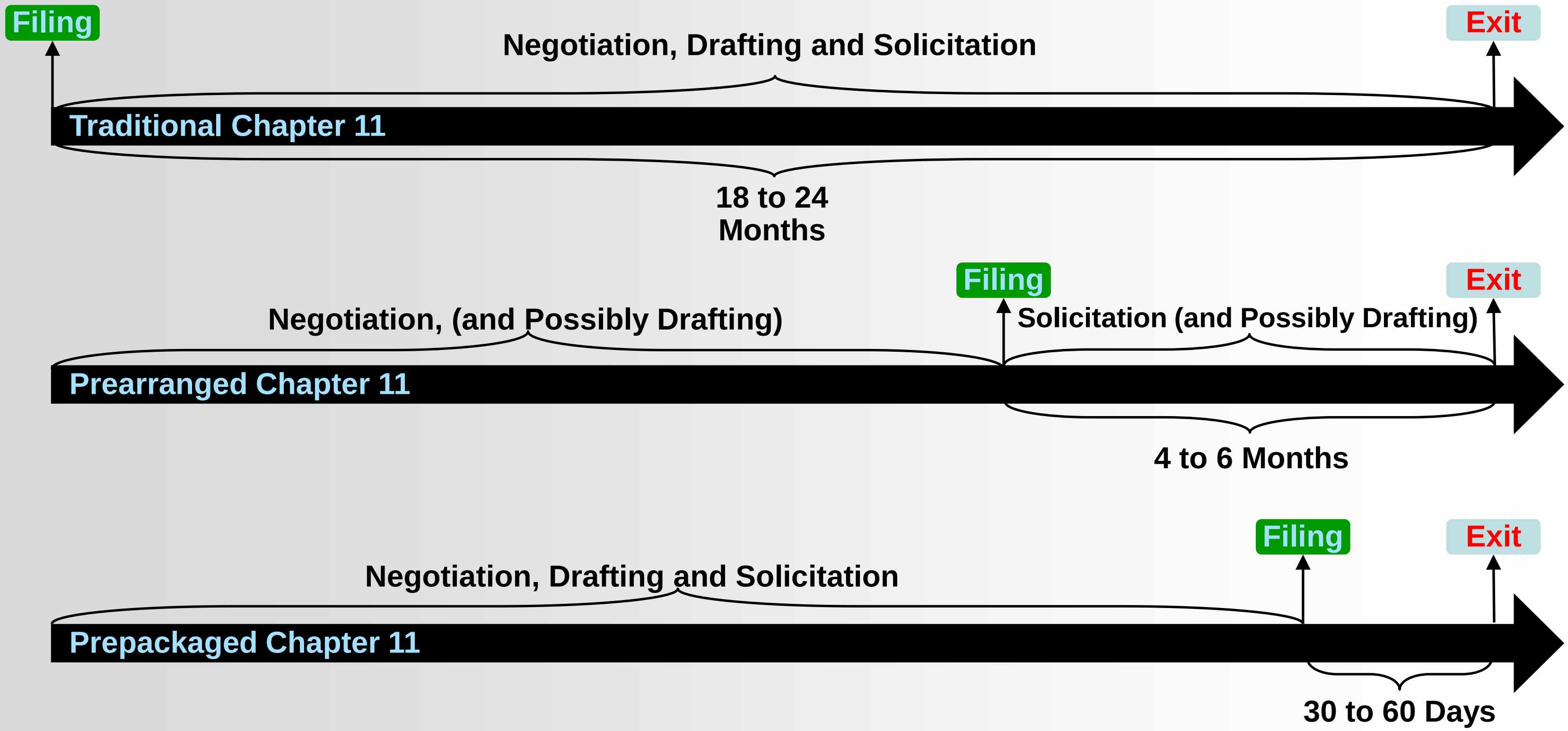
- **Benefits of Chapter 11**
  - Enhanced ability to restructure business and operations to maximize future profitability while avoiding liquidation
  - Automatic stay of litigation and collection activities
  - Obtain new financing (DIP financing)
  - Renegotiate or reject contracts and leases
  - Sell assets free and clear of liabilities
  - Resolve pending/threatened litigation and contingent claims through expedited claims allowance process, significantly shortening litigation timetable and expense
  - May allow avoidance and recovery of certain prepetition transfers
  - Can force creditors to the negotiating table to allow for reduction and/or modification of secured and unsecured debt-amount/term/interest rate/covenants
  - "Fresh Start" – prepetition debts are discharged

- **Burdens of Chapter 11**
  - Cannot pay prepetition obligations without court approval
  - Board and management have to maximize value of business and be fair to all constituents
  - Heightened disclosure obligations and need court approval for transactions outside ordinary course of business
  - Potential loss of management control and disruption to operations
  - Creditors and shareholders have standing to dispute management's plans and seek court intervention
  - Bankruptcy Court has final say on all aspects of the restructuring, not management
  - Potentially long process and significant associated costs
  - Valuation often becomes an expensive battleground

Comparison of Types of Chapter 11 Cases

CONFIRMING A PLAN OF REORGANIZATION

- The goal of any chapter 11 case is to confirm a plan of reorganization
- In a prepackaged or pre-negotiated chapter 11 case, the time between filing and confirmation is significantly shortened.



PLAN: DEVELOPMENT

- Although debtors file for chapter 11 for various reasons, a large debtor (in consultation with its major stakeholders) will go through the following steps in formulating a plan.
- In prepackaged and pre-arranged cases, the formulation and documentation of a plan of reorganization occurs in whole or in part prior to the commencement of the case.

1. Development of business plan –
Will turn on (a) specific problems precipitating debtor's filing and (b) perceived solution(s) to those problems

2. Determination of the debtor's enterprise value – Determine how much value there is to distribute among the debtor's stakeholders

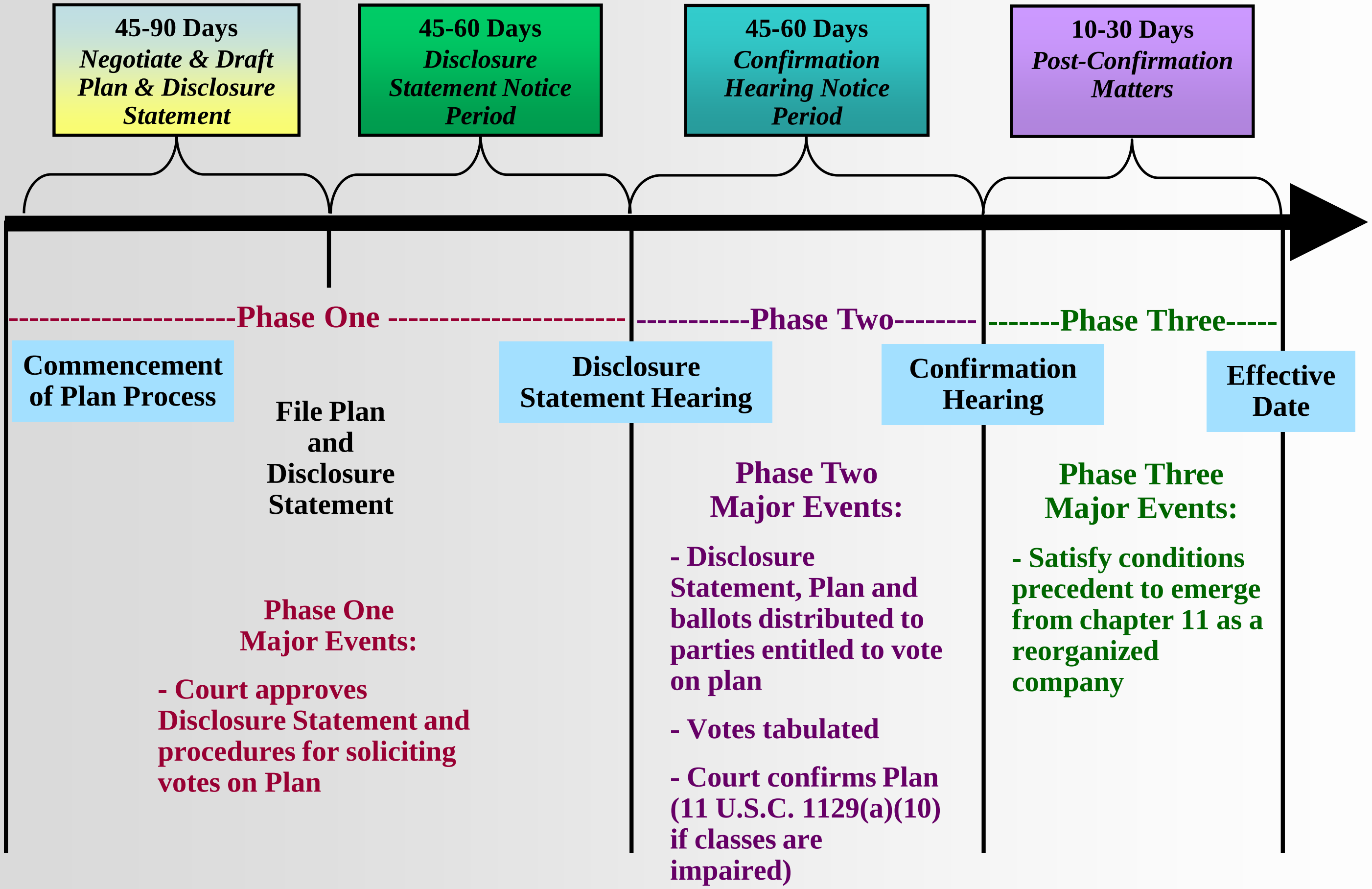
3. Determination of a "liquidation value" –
Created as a benchmark against which enterprise value is compared for various confirmation purposes

4. Formulation of new capital structure (e.g., how much and what type of new debt the reorganized company will carry) – Often a matter of significant debate among the debtor and its stakeholders

5. Negotiation of class treatment –
At the early stages of plan negotiation, the debtor will begin to map out the proposed distribution to each creditor class

6. Obtaining exit financing –
Most business debtors will require some sort of financing upon emergence

PLAN: APPROVAL PROCESS



Note: Days listed above are approximate and will vary from case to case.

PLAN: CONFIRMATION

- For plan to be approved, each impaired class must vote in favor by
  - 1/2 in number of claims actually voted
  - 2/3 in amount of claims actually voted
- Under certain circumstances, the plan may be "crammed down" over the objection of one or more impaired class if:
  - At least one impaired, non-insider class accepts the plan;
  - The plan is "fair and equitable"; and
  - The plan does not "unfairly discriminate"
- In addition, a plan must meet the "Best Interests of Creditors" test
  - As to EVERY creditor objecting to the plan, the Court must also find that the plan is providing that creditor AT LEAST AS MUCH as the creditor would receive in a chapter 7 liquidation
- Less common strategies, such as "death traps" and "gifting", must be thoughtfully tailored to ensure compliance with bankruptcy law
- After voting, plan is submitted to Court for confirmation
  - Among other criteria for confirmation, Court must be satisfied that the plan is feasible
- Upon entry of confirmation order, all parties are bound by the terms of the plan and all debts that arose prior to confirmation are discharged

SECTION 363 SALES

- Purpose of 363 sale?
  - Section 363 sales raise cash for the reorganizing debtor through the sale of non-core assets that will not be part of the reorganized business
- Usefulness of 363 sale?
  - Section 363 allows debtors to sell assets free and clear of liens, claims, and encumbrances (i.e. exceptionally clean title)
- What is required?
  - Bankruptcy courts will typically require a marketing or auction process to maximize value in 363 sales.
    - Minimum bids are typically set through a "Stalking Horse" agreement.
    - The Stalking Horse bidder will typically seek to protect its downside risk in the event a higher bidder emerges (breakup fee, expense reimbursement, overbid protection)
- Some other benefits?
  - Unlike under a plan, section 363 sales do not require creditor voting.
  - Bankruptcy courts will generally defer to a debtor's business judgment in granting approval, if the marketing process is thorough and fair
- Will the sale leave sufficient proceeds to satisfy administrative claims and confirm a liquidating chapter 11 plan?
  - The issue is getting more and more attention in recent 363 sale cases (e.g., Sears, Barneys, Exide, Brooks Brothers)

SALE VS. PLAN

Factor	Section 363 Asset Sale Process	Plan of Reorganization Process
Typical Structure	Asset sale	Flexibility in structuring
Timing	45-60 days	90-120 days
Scope	Transfer of assets only, which can include business as a going concern	Comprehensive resolution of bankruptcy and allows for purchase of subsidiaries and stock with US debt discharged
Form of Consideration	Cash or credit bid	Ability to use new securities (debt and equity) as consideration
Cost	Funding to closing is all that is required	Administrative claims (costs of entire bankruptcy) must be paid in full, but savings on real estate transfer taxes and ability to postpone certain priority taxes
DIP Financing	ABL lenders and stalking horse bidders typically require a budget tailored to permit debtor to reach closing	Plan sponsors must supply financing sufficient to show that Plan is feasible, and that debtor can exit bankruptcy
Bidder Protections	Breakup fee typically 3% of purchase price inclusive of expense reimbursement, plus incremental amount for initial topping bid	Breakup fee typically 3% of purchase price inclusive of expense reimbursement
Bid Dynamics	More likely to attract multiple bidders interested in comparable asset package or asset components	Values of individual assets less discernible but investment banker and advisors to creditors' committee will continue work to enhance value
Valuation Risk	Highest and best bid at auction determines valuation	Creditors' committee may have incentive to challenge plan valuation
Tax Issues	No special tax benefits (purchase accounting)	Possibility for enhanced tax treatment if certain requirements met
Approval	Bankruptcy court approval based on business judgment standard; no creditor consensus required although creditors' committee typically provides feedback on bids	Disclosure statement (prospectus describing transaction) must be approved first; creditors then vote on plan, and bankruptcy court approves following satisfaction of confirmation standards
Post-Closing Matters	Company will be required to develop a plan of reorganization or other mechanism for reconciling claims and distributing proceeds; funding may be limited following sale closing	Implementation of the plan, the funding for which must be specified in the plan

Out-of-Court Liability Management Strategies

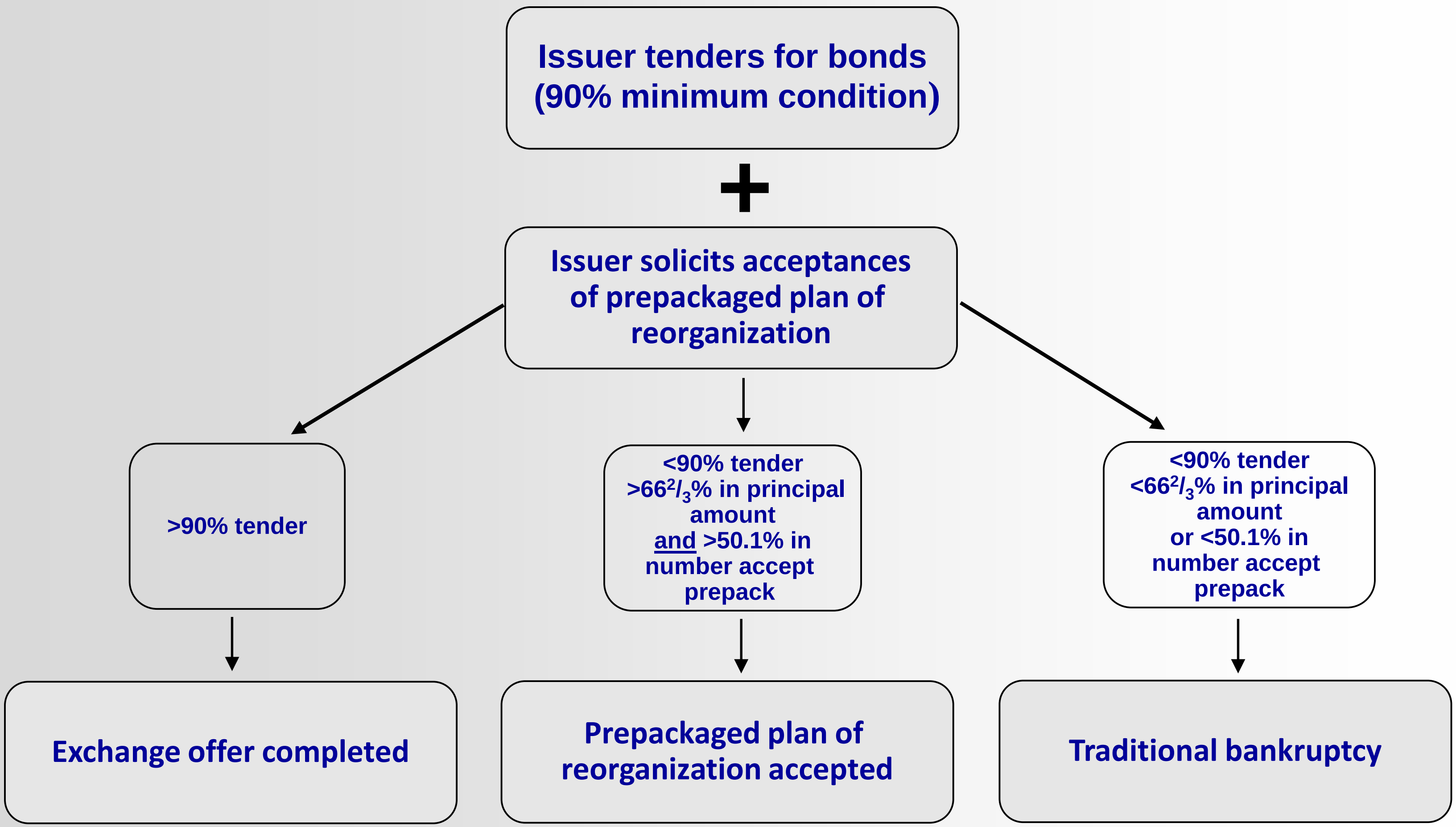
LIABILITY MANAGEMENT STRATEGIES: CERTAIN CONSIDERATIONS

- **Economic dynamics and objectives**
  - Trading prices
  - Mix of consideration
  - Company need to deleverage and/or reduce debt service requirements
  - Holdout problem in tenders and exchanges
    - Structuring transaction to incentivize holders to participate
- **Contractual limitations, particularly in debt agreements**
  - Debt and liens incurrence; leverage ratios
  - Restricted payments
  - Affiliate transactions
- **Equity as consideration**
  - Authorized shares
  - Stock exchange shareholder approval rights
  - Change of control provisions in agreements

Securities Act registration or exemption:

- To avoid burdensome disclosure and procedural requirements of registration, companies often seek to structure the exchange offer under an exemption from registration, such as :
  - Section 4(a)(2): Private placement
  - Section 3(a)(9): Non-cash exchange with existing holders; no paid solicitation
  - Section 1145: Bankruptcy Court approval
- Tender and exchange offers for convertible debt securities are subject to additional SEC filing and disclosure requirements

LIABILITY MANAGEMENT STRATEGIES: "DUAL TRACK" APPROACH



RESTRUCTURING SUPPORT AGREEMENTS

- Restructuring Support Agreements ("RSA") are agreements between the company and key stakeholders whereby the stakeholders agree to support a proposed restructuring

- RSAs are generally the result of extended discussions between the company and an organized group of stakeholders that started between professionals and advanced to principals once the stakeholders are willing to "get restricted" for a period of time

- RSAs typically include:
  - Identification of stakeholders
  - Commitment to support
  - Milestones
  - Limitations on transferability
  - Waiver or forbearance
  - Agreements to continue operating in the ordinary course

- RSAs reduce holdout risk in out-of-court context

- ***Cautionary Note:*** In re Stations Holdings Company, Inc., No. 02-10882 (Bankr. D. Del. Sept. 30, 2002); In re NII Holdings, Inc., No. 02-11505 (Bankr. D. Del. Oct. 22, 2002)
  - Judge Walrath held that postpetition lockup agreements violate section 1125(b). She was particularly concerned about the absence of any provision in the agreements that would have allowed the signatories to change their votes if the information in the subsequently filed disclosure statement turned out to be different from what they had previously received. She designated the votes of the signatories under section 1126.

RSA – PRACTICAL CONSIDERATIONS

- Like all contracts, RSA terms reflect the leverage of respective parties; however, some practical considerations should be kept in mind by all parties, such as:
  - **Multiple groups**: if there multiple tranches or constituencies, consider whether one global RSA is appropriate or an RSA for every group instead. If the latter, then consider including provisions that address cross-holders (such as drag-along on all held securities and conflict provisions)
  - **Milestones and termination rights**: having automatic or self-executing termination clauses can seem like a good idea when negotiating, but they can become a burden later when foot faults occur or timeline slips happen as the transaction is papered. Instead, consider requiring affirmative notice by a requisite group of holders or Company (as applicable) to terminate the RSA
  - **Directing indenture trustees or admin agents**: if the RSA includes collective action provisions under a credit agreement or indenture, does the RSA include the necessary direction to effective the provision
  - **Requisite consent thresholds**: >50% of holders party to the RSA is common, but keep in mind that if the RSA is open and allows others to join later (e.g. it has a signing or backstop premium or other incentive) or if the initial consenting group is large, that threshold may later become a burden if you need to get holders restricted to amend or make critical decisions
  - **Remedies for breach:** before agreeing to RSA covenants or representations, parties should ask themselves what the damage for breach may be? Are you ultimately better off if the remedy is termination of the RSA only?
  - **RSA participation fees**: it is not uncommon for creditors to ask for an RSA "fee", but beware, these can be controversial with bankruptcy courts and, if not offered to the entire class, may cause unexpected consequences for a chapter 11 plan
  - **Transfers**: the RSA should address the consequences of parties making transfers (joinders for buyers requiring them to vote, and "market maker" exceptions where appropriate

THE HOLDOUT PROBLEM

- Critical weakness of exchange offers
  - Particularly true for companies that are using an exchange offer as an alternative to an in-court restructuring
    - The exchange offer only binds accepting security holders, leaving "stub debt" behind; therefore, if the exchange offer is an alternative to an in-court restructuring, need to get substantially all holders to accept (typically >90%)
    - Bondholders (vulture funds typically) who can hold out of an exchange retain a bond with original payment terms, often with improved prospects for payment because of financial concessions made by the bondholders who exchanged
  - Still may be an issue even for companies not as troubled
    - Subject to blockage by group of holders, particularly when conditioned on high level of acceptance

THE HOLDOUT PROBLEM

The ability to exercise certain levers can vary greatly between out-of-court and chapter 11 scenarios, as illustrated below

Typical “levers” or “sticks”	Usual Thresholders Out of Court	Thresholds In Court
Credit Agreements		
Stripping Covenants	50.1%	66.66%
Extension of Maturity	100% (or each holder)	66.66%
Consent to Junior Securities or Layering	50.1%	66.66%
Consent to payment to junior debt	50.1%	66.66%
Affecting the right to or amount of payment	100% (or each holder)	66.66%
Senior Unsecured Notes		
Stripping Covenants	50.1%	66.66%
Releasing less than all or substantially all collateral	50.1%	66.66%
Extension of Maturity	100% (or each holder)	66.66%
Consent to payment to junior or subordinated securities	50.1%	66.66%
Affecting the right or amount of payment	100% (or each holder)	66.66%
Subordinated Securities		
Stripping Covenants	50.1%	66.66%
Extension of Maturity	100% (or each holder)	66.66%
Affecting the right to or amount of payment	100% (or each holder)	66.66%

STRATEGIES FOR THE HOLDOUT PROBLEM

- Carrots
  - Greater market value
  - Greater interest rate
  - Shorter maturities
  - Senior or secured position
  - More restrictive covenants
  - Increased equity position in the issuer
  - Cash payments
  - Instruments providing upside or downside protection (e.g. liquidation preferences, CVRs)
  - Early participation fees

- Sticks
  - Risk of bankruptcy if the exchange is not effected
  - Non-exchanging holders may own securities that are junior to those held by the exchanging holders
  - Exit consents – covenant stripping
  - Limited liquidity for holdouts following the exchange
  - Springing maturity dates for senior debt in the capital structure
  - Conditional closings
  - “Death Trap” plan provisions

Not all carrots and sticks are applicable in each situation

- Purpose of the exchange offer will dictate what is appropriate
- Covenants in existing debt may limit options

Prepackaged Cases

PREPACKAGED CHAPTER 11 CASES

Prepackaged Chapter 11 Cases were developed to deal with holdouts in exchange offers

How does it work?

- Entire negotiation conducted out of court
- Only when you have all the votes in hand, sufficient to confirm a plan, do you file for Chapter 11
- Then, seek to confirm the plan in 30 days and make it binding on all parties

Normally, company seeks to implement an exchange offer with the possibility of a prepack "backing up" or "stapled to" the exchange offer

- Carrot and stick
- Bankruptcy securities may be less favorable than those offered in the exchange offer

PREPACKAGED CHAPTER 11 CASES: LIMITATIONS

- The Bankruptcy Code generally provides that a debtor may solicit votes on a plan from holders of securities, and exchange securities under a plan, regardless of whether federal or state law would require the debtor to obtain a valid registration statement for such securities
- The SEC has taken the position that these exemptions do not apply to prepackaged bankruptcies
- Thus, a financially distressed debtor seeking a prepackaged bankruptcy must try to do either a registered or 3(a)(9) or 4(a)(2) solicitation
- Often, an exchange offer with a backup prepack is the way it is done

PREPACKAGED CASE STUDY: *ROUST*

- Issuer is one of largest spirit producers in Eastern Europe and was unexpectedly impacted by sanctions against Russia and devaluation of local currencies
- 90% of senior debt and over 90% of junior debt had agreed to restructuring in December 2016
- Issuer had substantial excise taxes due in January, the funding for which was a part of the restructuring transaction
- Solicitation commenced on December 1, 2016
- Following solicitation, sufficient votes were received by December 30; bankruptcy court agreed to hold confirmation hearing a week later, during first week of January 2017

PREPACKAGED CASE STUDY: *BELK*

- Belk, Inc. (Belk), a privately owned department store chain
- Filed for chapter 11 on February 23, 2021 based on an RSA that deleveraged $450 million of first and second lien term loan debt and the infusion of $225 million in new money to fund the going-forward business
- Solicitation commenced on January 26, 2021
- Prepackaged plan was accepted by 100% of creditors and shareholders that cast ballots with holders of over 99% of claims casting ballots
- Plan was confirmed in approximately 12 hours
- The court explained that the plan balanced the debtors' needs for expedited relief, including protecting 17,000 jobs and a lack of DIP financing
- Court resolved due process concerns with a due process order
  - The order set up a series of future hearings, including a hearing to approve the form of a new opt-out notice extending the opt-out deadline for third-party releases, and two status conferences, one on any due process based objections and the other on any objections to the assumption or rejection of executory contracts/leases
    - No due process-based objections were filed and only two objections to assumption were filed by the landlords
  - Also included a carve-out from retention of exclusive bankruptcy jurisdiction with respect to certain classes of claims so that individuals in other states would not be required to seek relief in Texas
  - Due process order would control over the confirmation order

PREPACKAGED CASE STUDY: *SECURE HOME*

- Secure Home Holdings LLC and its subsidiaries ("SHH") are a national provider of both commercial and residential technology advanced security solutions
- Beginning in late 2019, SHH began exploring several options to refinance, recapitalize, or pursue other strategic combinations, ultimately culminating in a balance sheet restructuring via a debt for equity swap with its first lien lenders
- SHH commenced solicitation on April 25, 2021, just prior to the chapter 11 filing; Judge Stickles (DE) confirmed the uncontested proposed modified plan at the May 25 confirmation hearing and the plan went effective on June 11
- Under the plan, $95 million of first lien secured claims were converted to equity, second lien lenders agreed to a $1 million waiver payment (plus $200K in fees), and $106.5 million of first lien and second lien deficiency claims were treated as GUCs receiving no distribution
- Under the reorganization plan, SSH managed to eliminate approximately $95 million in debt

Prenegotiated Cases

PRE-NEGOTIATED CHAPTER 11 CASES

Pre-Negotiated Cases involve no formal solicitation of votes, but rather a legally binding commitment of a “critical mass” of creditors to support a plan of reorganization upon receipt of a court-approved solicitation package

How does it work?

- Again, the negotiation is conducted out of court
- Typically, sufficient support ranges from not less than 34% of the fulcrum security up to 67% of the fulcrum security
- Pre-negotiated plans tend to be more subject to valuation risk than prepackaged cases
- Companies pursue pre-negotiated cases in circumstances where they are unable to identify a broad range of holders or where a substantial holder or group of holders approaches the company with a viable transaction

PRE-NEGOTIATED CASE STUDY: *MCCLATCHY*

- Company was facing significant liquidity constraints due to significant funded debt and pension obligations, in addition to challenges posed by consolidation and overall decline in the print media industry
- For several months prepetition, McClatchy engaged in discussions with the PBGC and its largest secured lenders to negotiate, respectively, a distress termination of its pension plan and an out of court restructuring of first, second and third lien debt
- Solicitation commenced the day prior to filing in February 2020, but no firm commitment threshold was obtained
- Following a contested process lasting almost 6 months, majority lenders' credit bid for substantially all of McClatchy's assets in 363 sale combined with a plan of distribution pursuant to which McClatchy shed around 55% of its total funded debt and executed a distress termination of its defined benefit pension plan was approved in September 2020

PRE-NEGOTIATED CASE STUDY: *EXIDE*

- Prior to its May 19, 2020 filing (the third in Exide's history), Exide experienced significant drains on liquidity and cash flows, largely as a result of mounting costs for environmental remediation and related litigation
- Exide engaged in negotiations with an Ad Hoc Group of secured bondholders, and the parties subsequently entered into an RSA pursuant to which (i) Exide would pursue a sale of Exide Americas and Exide Europe/ROW businesses, either together or separately, (ii) certain members of the Ad Hoc Group would provide DIP financing, and (iii) the Ad Hoc Group would submit a credit bid for the Exide Europe/ROW business
- Exide started a pre-petition marketing process for all of the company's assets and also requested approval of global procedures intended to serve as guidelines for reaching a consensual resolution for the orderly transfer of the NPPs to various state regulators and the EPA
- A global settlement of all environmental liabilities (other than with respect to California) was reached and incorporated into the plan
- The court approved 2 sales – The Americas sale was implemented through a 363 sale, and the Europe/Row sale was implemented as a plan sale through section 1123
- The court confirmed the plan of liquidation over California DTSC's objection, which incorporated the environmental settlement, including 3rd-party releases, and the European credit bid sale

Securities Law Hurdles

OVERVIEW: DISCLOSURE AND PROCEDURES

US restructurings which are effected in whole or in part prior to a bankruptcy filing must comply with the securities laws

- The Securities Act of 1933 (the "Securities Act" or the "33 Act") prohibits the offer of securities unless a registration statement containing voluminous prescribed information is filed with the SEC – including audited financial statements
  - "offer" means you can't even ask
  - the importance of preliminary "discussions"
  - The Securities Act prohibits the sale (including the resale) of securities unless the SEC has declared the registration statement "effective"
  - Strict liability for disclosure violations
  - Because the registration process is costly and time-consuming (See Registered Exchange Offers Section) - in restructuring we focus on exemptions
- The Securities Exchange Act of 1934 (the "Exchange Act" or the "34 Act") and the rules promulgated by the SEC to implement the '34 Act set forth procedures for soliciting the purchase or exchange of, and consents with respect to, outstanding securities
  - Rule 10b-5 – "insider information"
  - Self tender rules – Rule 13e
  - Tender (exchange) offer Rules – Rules 14d and 14e
  - Proxy Rules – soliciting shareholder not bondholder (unless bonds are convertible) consent
  - Trust Indenture Act

SECTION 3(A)(9) EXCHANGE OFFERS

Section 3(a)(9) provides an exemption from registration for "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange"

Generally, the character of the securities issued in a Section 3(a)(9) transaction is the same as the target securities, in terms of being restricted or freely tradable

- **Requirements**:
  - Same Issuer
  - Exclusively by Exchange
  - No Paid Solicitation
- **Benefits**:
  - Quick (no registration required) and flexible
  - Less, and in many cases no, SEC review of disclosure documents
  - Limited filings with SEC
  - Less expensive than registered offering
  - Securities retain same character before and after exchange (i.e., restricted or freely tradable)
  - Exemption applies regardless of number or type of holders
- **Limitations**:
  - Financial advisors cannot receive incentive compensation (discussed below)
  - May have restrictions on transfer of new securities if old securities were "restricted securities;" bond holders may require registration rights
  - Works best with concentrated group of sophisticated security holders
  - Holdout problem

SECTION 3(A)(9) EXCHANGE OFFERS: FINANCIAL ADVISOR ROLE

- Financial advisors should not:
  - Negotiate (as opposed to "discuss") with security holders
  - Make a recommendation regarding the exchange offer
  - Convey management's opinion on the exchange offer
- Engagement letter with the financial advisor must be drafted in accordance with these guidelines
  - No incentive compensation
  - Fee earned when definitive materials mailed to security holders – may be paid later

SECTION 3(A)(9) EXCHANGE OFFERS: FILING AND DISCLOSURE REQUIREMENTS

- No specific requirements where the target security is straight debt
- Regulation M-A if target security is equity, including convertible debt
  - Schedule TO
- Trust Indenture Act
  - Form T-3 must be filed for new debt securities
    - Filed with the SEC at the same time that the offer is commenced
    - Offer cannot be consummated until the SEC qualifies the indenture under the Trust Indenture Act
- FINRA
- Blue Sky Laws
  - No registration requirement; most states still require notice filings
- Exchanges
- Form 8-K

SECTION 4(a)(2) EXCHANGE OFFERS

Section 4(a)(2), commonly known as the private placement exemption, provides that the registration requirements do not apply to "transactions by an issuer not involving any public offering"

Rationale for the private placement exemption is that the extensive regulations applicable to public offerings are not required for offerings made to a limited number of offerees capable of protecting themselves

Sometimes called the "rich and smart" exemption

Purchasers are accepting the securities for "investment" not "resale" and must agree to hold the securities indefinitely

Requirements:

- Qualification of offerees : "rich and smart" (accredited)
- Availability of sufficient information about the issuer
- Absence of a public distribution of securities
- Limitations on resale: Purchasers may resell to QIBs, or a purchaser that the seller "reasonably believes" is a QIB, under Rule 144A without engaging in a "distribution"

SECTION 4(a)(2) EXCHANGE OFFERS: BENEFITS AND LIMITATIONS

- Benefits:
  - Works well with small group of sophisticated institutions
  - Quick (no registration required)
  - Unlike a Section 3(a)(9) exchange offer, issuer's financial advisors may participate fully in solicitation of the transaction
  - Minimal filing requirements

- Limitations:
  - Newly issued securities are restricted; may not be resold absent registration or an exemption from registration
  - Security holders may insist on registration rights
  - Identifying beneficial owners (to determine investor status) can be cumbersome
    - May use presumption and ask for investor representation (you may solicit investors you "reasonably believe" are accredited and ask them to confirm)
  - Generally limit offer to QIBs and accredited investors
    - In prepack context, may treat unaccredited holders as "no" votes
  - Holdout issue, which may be exacerbated as it is more difficult to reach the minimum threshold when non-qualified investors are excluded
  - May not be an option if exit consents are being sought
    - May need to solicit all holders to reach required consent level
    - Indenture may require the issuer to solicit all holders for consent

EXIT CONSENTS

Exchange offers may be accompanied by proposed modifications to the target security's covenants

Issuer solicits the exchanging security holders' consent to the modification (or elimination) of existing debt covenants concurrently

- The acceptance of the exchanged debt is often conditioned upon the consent to the covenant modifications
- These "exit consents" are designed to induce holders to accept the exchange offer because any benefit of nonparticipation is often outweighed by the loss from retaining securities stripped of desirable covenants

Companies can also seek covenant relief in a "stand-alone" consent solicitation

Indentures generally require 50% or 66 2/3% consent to change covenants

- Consent will bind all holders of the securities even if they do not vote in favor–unlike exchange offer

EXIT CONSENTS (CONT.)

- In general, duties to bondholders are contractual
  - Duties to preferred stockholders as to preferred rights are contractual and as to rights as stockholder are of a fiduciary nature
  - Given contractual obligations some have argued that consent solicitations have been structured to breach the implied covenant of good faith and fair dealing
- Timing issues
  - Sign the supplemental indenture before accepting securities in an exchange offer
    - Avoids the argument that the company is voting bonds that it owns
  - Although withdrawal rights are not required for straight debt, they should still be included if seeking exit consents
- Courts have upheld payments for consents if the payments are available to all holders who consent
  - Courts have upheld consent payments against charges that they constitute illegal vote buying if the payments are available to all who consent
  - In re Loral Space & Commc'ns Inc. (Del. Ch. Sept. 19, 2008), the court also upheld consent payments made only to certain noteholders based on the fact that the indenture was silent on the issue of consent payments and that there is no underlying right for equal consent payments to all bondholders because duties are contractual only

EXIT CONSENTS

- Two decisions – Marblegate Asset Management v. Education Management Corp. ("Education Management") and MeehanCombs Global Credit Opp. Fund, LP v. Caesars Entertainment Corp. ("Caesars") broadly interpreted section 316(b) to limit the ability of parties to strip guarantees from dissenting bondholders in an out-of-court restructuring without the bondholders' unanimous consent
  - The courts indicated that Section 316(b) protects bondholders "against non-consensual debt restructurings" that, as a practical (and not purely legal) matter, materially impair their ability to collect their debt, and rejected the narrower interpretation that Section 316(b) only protects bondholders from "majority amendment of certain 'core terms
  - Section 316(b) of the Trust Indenture Act ("TIA") provides that (with certain exemptions):
    - "Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder . . ."

- In January 2017, the Second Circuit overturned the District Court's decision in Marblegate and held that Section 316(b) only protects the legal right to payment
  - In overturning the lower court's interpretation that restricted coercive debt exchanges absent 100 percent consent, the Second Circuit preserved a company's ability to consummate out-of-court restructuring transactions
  - A strong current of so-called lender-on-lender violence has followed the reversal in Marblegate:
    - Asset stripping transactions like *J. Crew*
    - Uptiering transactions like *Quiksilver*

SECTION 1145 OF THE BANKRUPTCY CODE

Section 1145 of the Bankruptcy Code provides a limited exception from the registration requirements of the ’33 Act for the issuance of securities pursuant to a chapter 11 plan of reorganization

Creditors may receive new debt or equity securities of a debtor under a chapter 11 plan of reorganization in whole or in partial settlement of their claim

Section 1145 exempts from the registration requirements of the ’33 Act, the offer or sale by a debtor (including certain of its affiliates and successors) of its securities (including options, warrants, rights, and convertible securities) under a plan of reorganization in exchange for a claim or equity interest or principally in such an exchange and partly for cash or property to anyone other than an “underwriter” as defined in Section 1145(b)

- The exception for underwriters is limited to “real” underwriters (i.e., those engaged in a distribution of securities to the public)
- The exemption does not apply to new capital raises by a debtor

A security sold in a transaction that meets the requirements of Section 1145 is deemed to have been issued in a public offering

SECTION 1145 OF THE BANKRUPTCY CODE

- Section 1145 relieves reorganizing debtors, their creditors and the recipients of their equity of the burdens of compliance with the securities laws
- Issuer avoids the expensive and time-consuming registration process
- Securities issued to parties other than “underwriters” are deemed to have been issued in a public offering and are therefore not “restricted securities” as defined in Rule 144 of the ’33 Act
  - Securities are freely tradable, without restriction, regardless of whether the purchaser has or can obtain any information about the issuer or the security
  - Provides liquidity for creditors who receive securities in a chapter 11 reorganization
- Section 1145 does not provide any exemptions from the antifraud provisions of the securities laws