New Developments in Rights Offerings and Backstop Purchaser Incentives

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Overview

- 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 discount, during a set subscription period.
- Rights offerings can benefit both debtors and creditors/equity holders
  - Debtor increases liquidity and fortifies the balance sheet
  - Reduces reorganized debtor's leverage
  - Liquidity supports plan feasibility to avoid subsequent bankruptcy filing
  - Creditor has investment opportunity usually on favorable terms
  - Enhanced recovery on claims
  - Potential to resolve valuation disputes among constituents

Overview (Cont.)

- Key Components of a Rights Offering:
  - Backstop: One or more parties commit to subscribe for a minimum amount, in return for a commitment/backstop fee and other consideration (e.g., break-up fee, expense reimbursement).
  - 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.
  - Eligibility: Potential participants are typically a limited pool of creditors. Wide eligibility may increase support for the chapter 11 plan, but could also increase regulatory and administrative concerns.
  - Section 1145 Exemption: If the rights offering complies with §1145 of the Bankruptcy Code, no SEC registration is required. Debtors may 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 or "Block": The right afforded the backstop parties 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.

Securities Law Exemptions

- Registration with the SEC is a lengthy and expensive process, so Debtors proposing a rights offering generally try to fit within an exemptions from registration for rights offerings proposed under a plan.
- **Option 1:** Debtors may utilize Section 4(2) of the Securities Act of 1933, the "private placement" exemption for accredited investors, if certain conditions are met.
  - Securities issued to backstop parties will often be issued pursuant to this exemption
- **Option 2:** Section 1145 of the Bankruptcy Code provides that new securities may be exempt from registration requirements and freely tradeable (except by affiliates and statutory underwriters) if issued (1) pursuant to a plan of reorganization, (2) by the debtor (or its affiliate/successor), and (3) in exchange for claims against or interests in the debtor **or** "principally" in exchange for such claims or interests and "partly" for cash or property.
  - The principally/partly test requires that securities be sold or exchanged principally in exchange for existing claims and partly for new cash paid by the offeree.
  - Securities issued to backstop parties may be ineligible for exemption under section 1145.

Backstop & Commitment Agreements

- Backstop agreements are routinely used in rights offerings to ensure that the Debtor benefits from the full amount of the investment regardless of subscription.
- Securities law exemptions for backstopped components of rights offerings are difficult to qualify for.
  - Securities issued to backstop purchasers as consideration for their purchase commitment are not eligible for exemption under Rule 1145, since they are not issued in exchange for a claim.
  - The securities purchased under the backstop arrangements likewise do not qualify for exemption.
  - The securities acquired by backstop purchasers must therefore be issued pursuant to a securities law exemption—typically Section 4(a)(2) of the Securities Act and corresponding state law exemptions– and backstop purchasers typically require registration rights.
  - When a number of creditors participate together as backstop purchasers, they could be deemed to be acting as a group, raising issues where the issuer is publicly reporting.

Backstop & Commitment Agreements (cont.)

- Backstop agreements (also known as equity commitment agreements where the rights offering is for equity) typically include:
  - Commitment fee
    - Frequently 2-7% of total commitment amount, but varies
    - May be payable even if rights offering and plan are not consummated
    - Frequently payable in equity or securities but can be structured as a cash fee (e.g., if the plan is not consummated)
  - Sometimes a separate break-up fee in the event of an alternative transaction
  - Expense reimbursement
  - Termination rights, including MAEs
- When backstop parties are creditors with a claim in a bankruptcy case, a backstop is usually accompanied by an RSA to govern backstop parties' conduct with regard to their claims under the plan implementing the rights offering.
  - This locks in the creditors providing the backstop to vote in favor of the plan
  - Limits confirmation and process risk, as it provides the debtors with certainty that the plan and restructuring transactions will have creditor support to be consummated or expedited
- Because the backstop fee and backstop protections of the parties under the backstop or commitment agreement are not enforceable unless the agreement is approved by the bankruptcy court, the debtor may be required to seek court approval of the agreement before commencing the rights offering solicitation.

Common Objections to Bankruptcy Rights Offerings (cont.)

- Unfair Discrimination: Objecting parties may argue that section 1123(a)(4) is not met if not all creditors are allowed to participate in the rights offering or if the economic benefits are disproportionately allocated to the backstop parties.
  - It is becoming more commonplace for debtors to create a pot of cash or other consideration for ineligible holders in an effort to avoid an unfair discrimination objection. *See In re CHC Group, Ltd.*, No. 16-31854 (Bankr. N.D. Tex.), and *In re Seadrill Limited,* No. 16-60079 (Bankr. S.D. Tex.).
- Lack of Market Testing: the value of the securities being issued are artificially low, and that a market test of the securities is necessary to determine their true value.
- Improper Lock-Up: the backstop agreement chills alternative proposals which depresses value; especially important if an RSA is a component of the overall deal.
- Self-Dealing: an insider is the backstop party and is receiving (i) equity at an unwarranted discount to assumed plan value and (ii) excessive backstop/commitment fees
- Lack of Good Faith: Plan fails to maximize value, backstop parties receiving disproportionate value through rights offering, improper solicitation by linking participation in backstop with agreement to vote in favor of the plan
- Sub Rosa Plan: If backstop agreement (and/or RSA or PSA) is approved separate from the plan, then similar to *sub rosa* arguments in a section 363 sale, objectors may argue the agreement improperly dictates the terms of a chapter 11 plan
- Best Interests Test: Individual creditors may argue that value provided under plan on the effective date is less than what such creditor would have obtained in a chapter 7 liquidation

Common Objections to Bankruptcy Rights Offerings (cont.)

- Pricing. Rights offering share price (including valuation and discount) may be challenged as artificially low.
- Excessive Backstop Protections. Creditors may object to excessive or improper protections provided to the backstop parties, including;
  - Fees: commitment/backstop fees and break-up fees may be characterized as being excessive or unnecessary given the size and circumstances of the rights offering (e.g. when a steep discount is expected to incentivize broad participation).
  - Termination Provisions: when a backstop party has overly flexible or unilateral rights to terminate the rights offering, the transaction may be characterized as illusory because there is no true obligation to consummate the transaction.
  - Releases, Indemnity, Exculpation: backstop commitment agreements or support agreements that provide releases or indemnities may be challenged if the party is abusing its status for an improper advantage.
  - Governance Rights: if the backstop parties are to be afforded substantial governance rights, potential challenges may focus on limiting the backstop parties' control over the reorganized debtor.

Select Rights Offering Examples

Rights Offering				Backstop Fee	
Target Name	Emergence Date	RO Size	RO Discount to Equity Value[1]	Backstop Fee Formulation	Form of Payment
CHC Group Ltd.	March 2017	$300mm	30.8%[2]	$30.8 million[3]	2L Convertible Notes
Peabody					
Rights Offering	March 2017	$750mm	45.0%	8.0%	Common Stock
Private Placement		$750mm	35.0%	8.0%	Common Stock
Seadrill Ltd.					
Equity	July 2018	$200mm	80.0%	5.0%	Cash ($10mm)
Notes		$880mm	37.0%	5.0%	Cash ($43mm)
Breitburn Energy Partners LP					
Rights Offering	April 2018	$465mm	11.0%	10% (Backstop)	Common Stock
Private Placement		$310mm		5% (Termination)	Cash
Claire's	October 2018	$575mm	37.5%	3.5% (Backstop)	Preferred Equity and Cash[4]
				2.17% (Commitment)	Preferred Equity and Cash[5]
Pacific Drilling	--[6]	$460mm	46.9%	8.0% (Backstop)	Common Stock
				5.0% (Commitment)[7]	

Note: Discounts calculated before impact of MIP dilution.
(1) Based upon Disclosure Statement valuation unless otherwise noted.
(2) Calculated as 1 – $300 million investment / $433.3 million of equity value received.
(3) There were disputes in *CHC* over the percentages formulating the Backstop Fee (discussed herein).
(4) 66.67% paid in Preferred Equity, 33.33% paid in cash
(5) 70% paid in Preferred Equity, 30% paid in cash.
(6) Plan confirmed 10/31/2018.
(7) Backstop parties received a 5.0% fee on portions of the rights offering that had already been committed, and a 8.0% fee on uncommitted portions of the rights offering.

Case Study:
CHC Helicopters

CHC

- The CHC Plan included a rights offering as part of a settlement of issues between the UCC, the Debtors, and secured noteholders regarding treatment of claims pursuant to a chapter 11 plan.
  - The terms of the Rights Offering were as follows:
    - » $300 million capital raise for the purchase of $433.3 million in New Second Lien Convertible Notes
    - » $280 million of the rights offering (to purchase $404.4m in New Second Lien Convertible Notes) was allocated to the prepetition Secured Noteholders
    - » $20 million of the rights offering (to purchase $28.9m in New Second Lien Convertible Notes) was allocated to the prepetition Unsecured Noteholders
- The Rights Offering was fully backstopped by the "backstop commitment parties" which included certain prepetition Secured Noteholders and prepetition Unsecured Noteholders

CHC Helicopters – Objections Raised

- As compensation for their commitments, backstop parties received a $21.3 million "Put Option Premium":
  - Payable upon consummation of the Rights Offering as $30.8 million in New Second Lien Convertible Notes (after application of the Rights Offering discount)
  - Payable in cash if the Rights Offering was terminated under certain circumstances
- The UCC, Debtors, the Secured Noteholders and the Unsecured Noteholders signed a Plan Support Agreement and agreed to support the proposed Plan with the Rights Offering terms.
- Certain parties objected to approval of the Plan Support Agreement contemplating the Rights Offering and backstop, including:
  - The U.S. Trustee, who argued that the Rights Offering constituted a *Sub Rosa* plan, and that payment of backstop fees would chill bidding
  - Angelo Gordon/Cross Ocean – Minority Secured Noteholders, arguing that:
    - » Section 503(b) should apply to approval of the Put Option Premium; Debtors cannot prove that the payments are actual, necessary costs and expenses of preserving the bankruptcy estate;
    - » The Put Option Premium fails the business judgment standard of section 363(b) because they are above market and therefore unreasonable
    - » Providing the Put Option Premium to the backstop parties (who were also prepetition Secured Noteholders) constituted unfair discrimination against non-backstop parties.

CHC Helicopters – Objections Overruled

- The Court conducted a multi-day trial regarding approval of the Plan Support Agreement and the proposed Rights Offering, which included competing expert witnesses and testimony from backstop parties.
- **PSA**: The Court overruled all objections to the Plan Support Agreement, finding that:
  - Fees: While the fees were high, they were reasonable in light of the totality of the circumstances present in the case.
    - » Evidence presented at trial indicated that the fees were necessary to obtain firm commitments from the backstop parties and that the Debtors believed the commitments to fund were necessary and reasonable. At least two of the Backstop Parties indicated that they would not commit to backstop the rights offering if the fees were reduced by any amount.
  - $21.3 million Termination Fee: The Fee was supported by the Backstop Parties agreeing to enter into long-term NDAs that allowed the parties to engage in many months of negotiations, and by the Debtors' ability to obtain $300mm in commitments when financial projections had been reduced.
  - Put Option Premium ($30.8mm in 2L Convertible Notes): Court noted that the 2L Convertible Notes were not entitled to interest and were mandatorily convertible, ultimately found that with the premium was "high," it was nevertheless reasonable under the facts and circumstances of the case.

CHC Helicopters – Objections Overruled (cont.)

- 1123(a)(4) Arguments: The Court found that payment of the Put Option Premium was NOT on account of the backstop parties' existing holdings, and therefore did not give rise to disparate treatment.
  - » The CHC Plan was not patently unconfirmable based on the record established at the hearing.
  - » The Court found it notable that the Committee was supportive of the Plan Support Agreement given the significant benefits that were being provided to the Debtors' estates and unsecured creditors.
- Sub Rosa Plan: The PSA was merely a framework for the CHC Plan, and did not impermissibly dictate the terms of the plan.
  - » The Debtors still had to satisfy the requirements of the Bankruptcy Code at Confirmation and retained a fiduciary out if a better alternative were presented.
- Court specifically preserved all parties rights to object to confirmation of the Plan.

- **Confirmation** – KLS Diversified Asset Management, a non-consenting noteholder, tried to raise similar issues again at Confirmation (including that the backstop protections violated 1123(a)(4)), and their objections were again overruled, and the Plan confirmed.
  - Absent new evidence, there was no basis for the Court to change its ruling from the PSA hearing.

Case Study:
Peabody Energy Corporation

- $1.5 billion equity capital raise on the following terms:

	Rights Offering	Private Placement
Amount	$750 million	$750 million
Rights Distributed	Reorganized PEC Common Stock	Convertible preferred equity of Reorganized PEC (convertible to Reorganized PEC Common Stock) (the "Preferred Equity")
Eligible Participants	Allowed Second Lien Notes Claims Allowed Unsecured Notes Claims	Allowed Second Lien Notes Claims Allowed Unsecured Notes Claims
Backstop Parties	Parties to Rights Offering Backstop Commitment Agreement ("BCA")	N/A
Allocation	Rights distributed *pro rata* on account of claims in the above classes	Determined by Private Placement Agreement ("PPA")
Requirements for Participation	None (subject to certain securities law qualifications)	All participants (subject to certain securities law qualifications) must become parties to: (i) the PPA; (ii) the BCA; and (iii) the Plan Support Agreement ("PSA")

Peabody Energy Corporation – PSA, BCA, PPA Motion

- On December 22-23, 2016, the PEC Debtors filed a motion to approve the BCA and PPA and to authorize the Debtors to enter into a PSA, the BCA, and the PPA (the "Motion")
  - At the time the Motion was filed, the PSA, BCA, and PPA had already been agreed to by a group of supporting noteholders (including both Second Lien Notes and Unsecured Notes) (the "Noteholder Co-Proponents")
- The PPA provided for the following allocation of the Preferred Equity:
  - Phase I: 22.5% of the Preferred Equity available only to the Noteholder Co-Proponents
  - Phase II: 5% of the Preferred Equity available to the Noteholder Co-Proponents and additional holders that signed on to the by an initial "Phase II" deadline on a *pro rata* basis
  - Phase III: 72.5% of the Preferred Equity available to the Noteholder Co-Proponents, the Phase II Parties, and additional holders that signed on to the PPA by a second "Phase III" deadline on a *pro rata* basis

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Peabody Energy Corporation – Challenges Raised

- Objectors argued that rights offering created unfair discrimination in violation of 1123(a)(4), alleging that holders of identical claims received different recoveries due to whether, and when, such holder determined to execute the PSA/PPA/BCA.
    - This issue raised the question of whether distributions received on from participation in the backstop were distributions on account of the participant's ***claim*** against the debtor (arguably requiring equal treatment), or on account of the ***new money provided*** (where different treatment is permissible)
        - The Plan expressly provided that the right to participate was <u>not</u> given "on account of" any purchaser's claim.
        - Objectors, however, tried to analogize the Supreme Court's decision in *Bank of Am. Nat. Trust and Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 451 (1999), to support their unfair discrimination objection.
    - Debtors claimed they were not obligated to offer the opportunity to purchase Preferred Equity to all members of a class, but legally entitled to offer the opportunity to only certain class members

Peabody Energy Corporation – Challenges Raised (cont'd)

- Objectors also argued violations of the "good faith" requirement of 1129(a)(3) of the Bankruptcy Code, including because:
  - If the Preferred Equity was not distributed "on account of" claims, the Debtors were obligated to maximize the value received for the Preferred Equity, and because the Preferred Equity was sold at a discount to Plan Equity Value, the Debtors failed to secure the maximum price they could have received for the Preferred Equity; and
  - Parties negotiating for class-wide resolution of inter-class disputes received greater recoveries than other class members merely by virtue of having been at the negotiating table, and the voting process was manipulated to ensure confirmation (as plan support was required for participation)
- Debtors and Plan supporters contended that:
  - Market test was satisfied by fiduciary out, and that the Debtors did receive and consider a competing proposal; and
  - That it was necessary for creditors to agree to support the Plan as a condition to participating in the Private Placement because otherwise a participating party could have sought to undermine the Plan solely to obtain a break-up fee.

Peabody Energy Corporation – Conclusion

- Bankruptcy Court rejected Plan objections and confirmed the Plan.
- An ad hoc group of non-consenting noteholders (the "Ad Hoc Group") appealed the Peabody Confirmation Order and the order approving the PPA and the BCA.
  - The Ad Hoc Group sought a stay from the District Court, which was denied, and the Plan went effective.
- The Reorganized Debtors, the UCC, and participants in the Rights Offering moved to dismiss the appeal as equitably moot, and urged the District Court to affirm on the merits.
- The District Court issued a 20-page written opinion both affirming the Bankruptcy Court on the merits and, in the alternative, holding that the appeal was equitably moot.
  - The Court concluded that the Ad Hoc Group's arguments improperly conflated equal treatment of *claims* with equal treatment of *claimants*.
  - The Court rejected the notion that the Debtors had to make the opportunity available to all claimants, noting that the PPA was "not merely a benefit, but also an obligation and a commitment to refrain from trading and to purchase a substantial amount of equity with the attendant risk of substantial loss. Indeed the risk of loss was particularly great at the time the agreements were entered."
  - The Court also rejected reliance on *LaSalle*, noting, among other things, that alternatives were considered.
  - On good faith, the Court found, among other things, that: (i) "the Plan was a good-faith attempt to provide the most recovery to creditors, satisfy a wide variety of stakeholders, and expeditiously emerge from bankruptcy with a feasible plan," and (ii) "all parties could have participated in the mediation, including the Ad Hoc Committee . . . ."
- The Ad Hoc Group subsequently appealed to the Eighth Circuit.
  - Briefing was completed in mid-September, and the appeal remains pending.

Case Study: Seadrill Ltd.

- $1.08 billion capital raise comprised of:
  - $880 million New Secured Notes ("NSN") Rights Offering, participants received NSNs stapled with 57.5% of the equity in Reorganized Seadrill
  - $200 million Equity Rights Offering, participants received 25% of the equity in Reorganized Seadrill
- Backstop parties committed to purchase $760.6 million of the NSN Rights Offering, and $151.9 million of the Equity Rights Offering, with the option to additionally backstop any portions that General Unsecured Creditors did not participate in.
- General Unsecured Creditors were initially permitted to participate in $64.2 million of the NSN Rights Offering and $18.9 million of the Equity Rights Offering.
- The RSA and the Investment Agreement contained several fees for the Backstop Parties, including:
  - Structuring Fee
    - 5.0% of the equity in Reorganized Seadrill, paid exclusively to the controlling shareholder
    - 0.5% of the equity in Reorganized Seadrill, paid to the other Backstop Parties
  - Commitment Fee
    - 5.0% of the equity in Reorganized Seadrill, paid to the Backstop Parties
  - NSN Closing Fee
    - 1% of the amount of issued NSNs, paid to all participants in the NSN Rights Offering

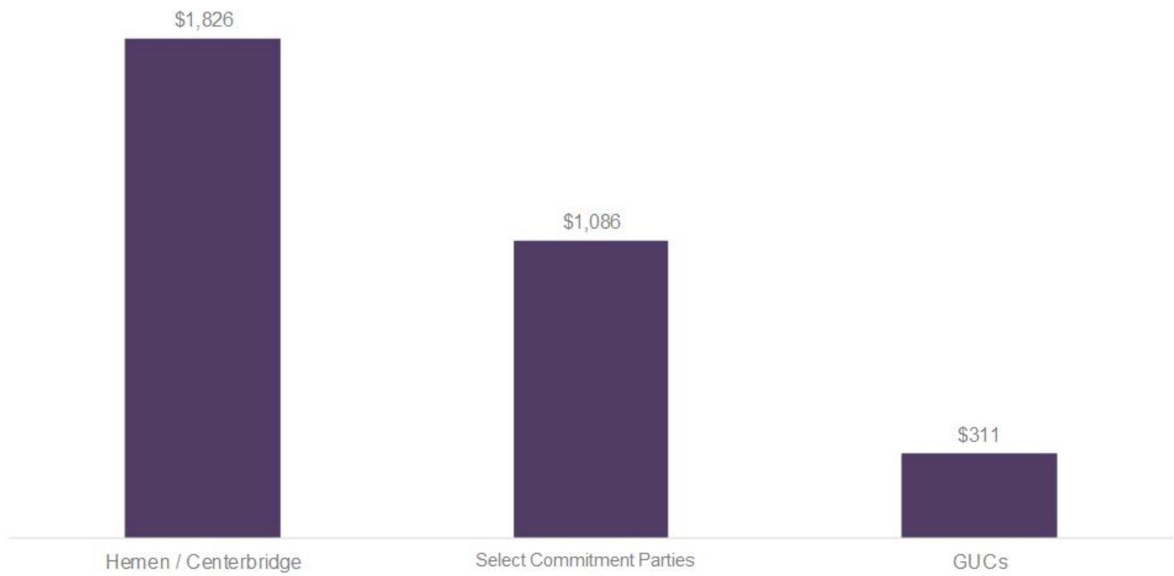
Seadrill Ltd. – Initial Rights Offering Allocations

New Money Investment Value Received by Stakeholders

Midpoint Houlihan Lokey Equity Value with Assumption of Newbuild Contracts

($ in millions)

NET VALUE RECEIVED IN EXCESS OF INVESTED AMOUNT



	Hemen / Centerbridge	Select Commitment Parties	GUCs
Unsecured Notes	**$228**	**$684**	**$1,720**
Right to Purchase New Securities (NSNs + Equity)	$565	$385	$110
Participation Right as % of Unsecured Bond Holdings	248%	56%	6%
Embedded Return (Profit) on New Money Investment	323%	282%	283%

Source: The information in this chart can be calculated from Exhibit H to the Disclosure Statement, but is not disclosed in the Disclosure Statement.

Notes: Assumes 100% GUC participation in rights offering

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Seadrill Ltd. – Challenges Raised & Negotiations

- The UCC and an ad hoc group of unsecured noteholders raised informal objections both the backstop fees and the outsized allocation of both Rights Offerings to the Backstop Parties.
- As part of a global settlement following extensive negotiations, the UCC was able to obtain the following modifications to the Rights Offerings:
  - Substantially increased allocations of the NSN Rights Offering and the Equity Rights Offering for General Unsecured Creditors, resulting in a $275 million or 50% increase in General Unsecured Creditor recoveries
    - General Unsecured Creditors were permitted to participate in $119.4 million of the NSN Rights Offering (increased from the initially proposed $64.2 million) and $48.1 million of the Equity Rights Offering (increased from the initially proposed $18.9 million).
  - General Unsecured Creditors who were not 'qualified investors' received a cash-out of 7% of their pro rata allocation of NSNs and 3% of their pro rata allocation of the Equity Rights Offering.
  - The ability of the ad hoc noteholder group to participate in a portion of the backstop.
  - Registration Rights for holders of 1% or more of the Reorganized Equity.

Seadrill Ltd. – Rights Offering Allocations Post-Settlement

Seadrill

Implied Change in Total Consideration and Recovery to Other General Unsecured Creditors[1]

Assumes Mid-Point Plan Equity Value of $3.9B[2]

($ in millions)

TOTAL CONSIDERATION

IMPLIED RECOVERY

Notes: (1) Other General Unsecured Creditors defined as non-Commitment Party GUCs, including other bondholders, swaps, unpaid trade, and Shipyards.
(2) Based on the Debtor's mid-point plan equity value of $3.9B; for illustrative purposes, the analysis does not reflect cash payments to non-accredited investor in-lieu of their rights and assumes the full $23M is added to the cash consideration to Other General Unsecured Creditors. To the extent non-accredited investors receive cash in lieu of their rights, the cash consideration to Other General Unsecured Creditors will be lower and result in lower recoveries.

Case Study: Breitburn Energy Partners LP

- $775 million equity capital raise, consisting of:
  - $465 million rights offering for common equity; and
  - $310 million private placement for convertible preferred equity
- The Debtors' Plan provided that, on the effective date, the Debtors' businesses would be split into two newly formed entities:
  - LegacyCo, which would be comprised of all of the Debtors' existing business operations, other than certain of the Debtors' assets located in the Permian Basin (the "<u>Permian Assets</u>"); and
  - New Permian LLC, which would own the Permian Assets and be wholly-owned by newly-formed New Permian Corp. New Permian Corp. would also own 7.5% of the equity of LegacyCo.
- The relevant classes under the Debtors' Plan included (a) the First Lien Claimholders, (b) the Second Lien Noteholders and (c) the Unsecured Noteholders.
  - The Second Lien Noteholders and the Unsecured Noteholders were eligible to participate in the private placement and the rights offering (pro rata).

Breitburn Energy Partners LP

- An Ad Hoc Group of Noteholders would fund a $310 million private placement to acquire 40% of the equity of PermianCo (the "Minimum Allocation Rights").
- The Ad Hoc Group of Noteholders also granted the Debtors an option (the "Put Option") to require them to purchase any PermianCo shares that were not purchased pursuant to the rights offering on the closing date.
- Each Unsecured Noteholder that was an accredited investor would be granted the right to participate in the rights offering to acquire 60% of PermianCo's equity for an aggregate subscription price of $465 million.
- On the Plan's effective date, PermianCo would purchase all of New Permian LLC's equity and 7.5% of LegacyCo's equity.

Breitburn Energy Partners LP

- The Ad Hoc Group of Noteholders received a premium on the effective date of the Plan comprising of 10% of PermianCo's equity outstanding on the Plan's effective date (the "Put Option Premium") for their backstop commitment.
- If the Backstop Agreement was terminated as a result of certain conditions (including a breach by the Debtors), each member of the Ad Hoc Group of Noteholders would receive a cash payment equal to its pro rata share of $38.75 million (5% of $775 million) (the "Breakup Premium").
- The Breakup Premium was an agreed to administrative expense that would be paid after all claims arising under the Second Lien Notes were paid in full in cash.
- The Debtors agreed to:
  - Reimburse the Ad Hoc Groups of Noteholders and the Second Lien Noteholders for their reasonable and documented fees and expenses incurred in these chapter 11 cases, including professional fees and expenses (the "Expense Reimbursement Obligations"); and
  - Indemnify such parties for all losses, claims, damages, liabilities and costs and expenses arising out of or in connection with the Backstop Agreement, the Plan and the transactions contemplated thereunder (the "Indemnification Obligations").

Breitburn Energy Partners LP - Objections

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- The statutory committee of equity security holders (the "Equity Committee") and an Unsecured Noteholder objected to the Plan and argued, among other things, that:
  - The rights offering and the proposed backstop were really just a disguised sale under section 363 of the Bankruptcy Code and thus subject to the requirements thereunder;
  - The Backstop Commitment Agreement created different treatment for claims in the same class in violation of section 1123 of the Bankruptcy Code; and
  - The Plan unfairly discriminated against Class 5B.
- The court denied confirmation of the Debtors' first plan because Class 5B received a significantly smaller recovery than Classes 5A and 7, and less than Class 6. The Eligible Offerees in Class 5A that participated in the rights offering would receive approximately $867.5 million in Plan recoveries in exchange for a contribution of $775 million, or an approximate 11.94% dividend. Class 5B would receive an approximate 4.5% dividend. Class 6, the other general unsecured creditors, would receive approximately 7%.
- The Debtors remedied the issue concerning Class 5B by providing Class 5B holders with:
  - A number of New Permian Corp shares having a value equal to 4.5% of the holder's Allowed Unsecured Notes Claim; and
  - Cash in the amount of 7.44% of the holder's Allowed Unsecured Notes Claim.

Case Study:
Claire's Inc.

- $575 million capital raise comprised of:
  - $75 million new Exit ABL Revolving Credit Facility
  - $250 million new First Lien Exit Term Loan
  - $250 million preferred equity interests in Reorganized Claire's Parent (collectively with the above, the "New Money Investment").
- First Lien Holders were given the right to participate in 50% of the New Money Investment, with the remaining 50% opened to Claire's shareholders.
- Second Lien Holders were not permitted to participate in the New Money Investment
- The Backstop Parties committed to fund any remaining New Money Investment, in return for the following fees and premiums:
  - Commitment Fee: $17.5 million in preferred equity interests, $8.75 million in cash
  - Backstop Put Premium: $8.75 million in preferred equity interests, $3.75 million in cash.

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Claire's Inc. – Challenges Raised

- Oaktree, holder of more than 70% of the Second Lien Notes, objected to the Debtors' Rights Offering Procedures, arguing that:
  - The proposed Rights Offering was an impermissible use of estate property outside the ordinary course of business, necessitating a section 363 Motion
  - The Debtors sought relief only under section 105(a)
  - There was no legitimate business purpose for the Rights Offering
    - The primary beneficiary of the Rights Offering was Apollo—a Backstop Party, a First Lien Holder, and controlling shareholder of Claire's Inc.
  - The New Money Investment was not market-tested, in violation of *203 N. LaSalle*
- Judge Walrath overruled Oaktree's objection to the Rights Offering, noting that it raised issues better left for Confirmation.
- Oaktree's objections to the Rights Offering were resolved prior to Confirmation, following, among other things; (i) an increase in the size of the cash pool going to the Second Lien Noteholders, and (ii) the issuance of $16.3 million in a contingent value rights cash pool for Second Lien Noteholders.
- No party objected to the terms of the Rights Offering at the Claire's Confirmation Hearing, and the Plan was confirmed on September 21, 2018.

Case Study: Pacific Drilling

- *Initial August 2018 Offering (proposed by Debtors and Ad Hoc Group):*
  - $400 million rights offering open to three classes of creditors to buy common stock at 46.9% discount to plan value
  - Additional $100 million private placement to an "Ad Hoc Group" of debt holders, to purchase additional stock at same discount to plan value as rights offering.
  - The Ad Hoc Group was also to receive an backstop fee od 8% of the entire $500 million offering in discounted reorganized equity.
  - Opposed by Quantum Pacific (majority equity owner)
- *Quantum Pacific Competing Proposal*:
  - $400 million rights offering
  - 7% backstop fee (available to any creditors committing by early election deadline)
  - $100 million private placement for Quantum Pacific (higher buy-in price than August 2018 proposal).

Pacific Drilling – Revised Terms

- The Debtors, the Ad Hoc Group and Quantum Pacific were sent court-ordered mediation to resolve disputes about the terms of the proposed equity rights offering.
  - After a successful mediation, the parties agreed on a $350 million rights offering, a $100 million private placement for the Ad Hoc Group, a $50 million private placement for Quantum Pacific, and an 8% backstop fee, and were able to present the Motion to Judge Wiles on a fully consensual basis.
  - Court raised further concerns with the revised proposal – in particular that (i) the private placement for the ad hoc group was not equitable, and (ii) the backstop fee was not reasonable, given that it was being paid in stock at a high discount to Plan value.
- In response to Judge's rulings, parties proposed a further revised proposal on the following terms;
  - $500 million capital raise comprised of:
    - $460 million rights offering to purchase 58.9% of reorganized equity, offered at a 46.9% discount to Plan value
    - $40 million private placement for Quantum Pacific to purchase 5.1% of reorganized equity
  - The Backstop Parties would receive the following commitment fees:
    - 8.0% of the uncommitted portions of the equity offering, payable in equity.
    - 5.0% of the committed portions of the equity offering, payable in equity.

Pacific Drilling – Conclusion

- Judge Wiles approved the revised proposal, noting in particular that no creditor had objected.
- Despite the consensual nature of the relief sought, the Judge expressed certain "misgivings", noting that:
  - "As I said last week, as a business matter the Debtors just want to get out of bankruptcy. They can agree to reasonable fees as part of a financing, but it is for the courts to decide whether fees are reasonable or not and to decide **whether, in effect, some larger creditors are really being given an unequal and preferential treatment that is disguised as a financing term**."
  - "I cannot help but continue to be skeptical based on the evidence I have as to the proposed backstop fee and the alleged need for it in this case. That is particularly true as to the Ad Hoc Group's own commitments to exercise their rights in the rights offering. **They have ample economic incentive to exercise those rights and, in fact, participated in structuring those rights to make them attractive to themselves. They have already committed to exercise their rights as part of a Plan Support Agreement with other parties. I am concerned that nobody else was given a similar opportunity, which raises the possibility again that the backstop fee is really just an extra payment and an extra recovery rather than a reasonable, stand-alone financing term**."[1]

(1) *In re Pacific Drilling*, 17-13193 , Bankr. S.D.N.Y. [Dkt. No. 631], at 5, 10 (October 1, 2018).