



AMERICAN
BANKRUPTCY
INSTITUTE

2018 Winter Leadership Conference

Attorneys and Advisors for All of Us: Representation of Directors and Managers in the Sale of Debtor Assets

*Hosted by the Asset Sales and
Financial Advisors & Investment
Banking Committees*

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Considerations Regarding Appointment of Independent Directors/Managers and Retention of Professionals

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Role of Independent Directors

- ❑ Dispassionate interest in the performance of the business, evaluation of management effectiveness, and evaluation of strategic alternatives
 - Review and evaluation of corporate objectives and strategic direction and business decisions of the company
 - Review and evaluation of financial results
 - Effective corporate governance
 - Evaluation of management
 - Capital allocation decisions
 - Strategic restructuring decisions
 - Out-of-court or chapter 11 restructuring
 - Asset sales or sale of the business
 - Ensuring adequate liquidity
 - Post reorganization capital structure

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Why Does an Entity Require Independent Directors/Managers?

- ❑ Identification, review and effective treatment of potential or actual conflicts of interest?
 - Intercompany issues and intercompany claims
 - Multiple silos in the capital structure
 - Potential asset sales/business transactions with various impacts and effect on collateral and guarantee and secured claims
 - Multiple secured creditors with differing collateral
 - Business transactions with insiders
 - Evaluation of:
 - Fraudulent conveyance claims
 - Contract claims
 - Other claims
 - Allocation of shared administrative services and related costs

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Corporate Analysis

- ❑ Corporate Governance
 - Analysis of the existing corporate governance structure
 - How long has the board been in place?
 - Under what circumstances was the current board appointed?
 - Are there existing, independent board committees?
 - Are there subsidiaries with separate boards?
- ❑ Capital structure
 - Analysis of debt and equity capital structure
 - Debt silos: Senior vs. subordinated. Secured vs. unsecured. Structural corporate seniority and subordination.
 - Creditor constituencies: How diverse are they?
 - Solvent and insolvent debtor entities
 - Domestic and foreign debtor entities

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Corporate Analysis

- ❑ Insolvency
 - Analysis of transactions giving rise to pending insolvency
 - Which entities are likely to file for chapter 11?
- ❑ Conflicts
 - Analysis of intercompany claims and transfer of funds and assets among subsidiary and parent companies and affiliates
 - Analysis of distributions to shareholders
 - Analysis of historic and proposed transactions with officers, directors, shareholders and affiliates

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Prepetition Appointment of Independent Directors

- ❑ A restructuring process guided by the independent directors or a special committee of independent directors:
 - Helps instill confidence in the restructuring process
 - Validates debtor restructuring proposals
 - Act as a critical buffer against unfair restructuring and asset sale proposals from existing management and/or shareholders
 - Facilitates negotiations with creditors and between different classes of creditors, other claimholders and stakeholders

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Prepetition Appointment of Independent Directors

- ❑ Prepetition appointment of independent directors:
 - Establishes independent ability to begin a review and investigation of conflicts, insolvency issues, fraudulent conveyance claims, and other potential claims in advance of a chapter 11 filing
 - Could reduce time spent in chapter 11
 - Could preclude the need for an Examiner or a Trustee
 - Likely requires separate retention of counsel and financial advisors
 - Costs may be substantial

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Post-Petition Role of Independent Directors

- ❑ Post-petition, independent directors continue to facilitate restructuring negotiations
 - Interplay between independent investigation and “priority of liens” provisions in DIP/Cash Collateral orders
- ❑ Use of independent directors can avoid a parallel, expensive standing dispute with the official committee(s)
 - Power struggle with Creditors Committee for control over investigation/claims
 - Conflict of Interests with respect to a single Creditors Committee

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Post-Petition Role of Independent Directors

- ❑ Post-petition, independent directors can be instrumental in negotiating through potential conflicts between the estates, including in the context of asset sales:
 - Tax and regulatory considerations
 - Nature of what is being marketed for sale
 - Sale of subsidiary's assets vs. sale of parent's equity
 - Debt-for-debt transaction
 - Debt-for-equity transaction
 - Evaluation of inter-estate releases
 - Impact on remaining business operations
- ❑ For situations with multiple entities and "multi-silo" structures and transactions, independent directors may be required for each entity
 - Multi-silo structures and transactions can accelerate a 9019 process, particularly where there a significant number of highly fact-specific claims

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Role of Independent Directors

- ❑ **Even with independent directors, a robust governance and decision-making process is critical and likely to be heavily scrutinized**

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Role of Independent Directors/Managers and Retention of Professionals in the Puerto Rico Case

May 2009

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Puerto Rico Sales Tax Financing Corporation (“COFINA”)

- ☐ Created in 2007 as a special purpose vehicle that is also a statutory instrumentality of the Commonwealth of Puerto Rico.
- ☐ Issued bonds, the proceeds of which were used to pay Commonwealth debt and expenses. The bonds were secured by a share of sales and use tax levied by the Commonwealth, and were non-recourse as to the Commonwealth itself.

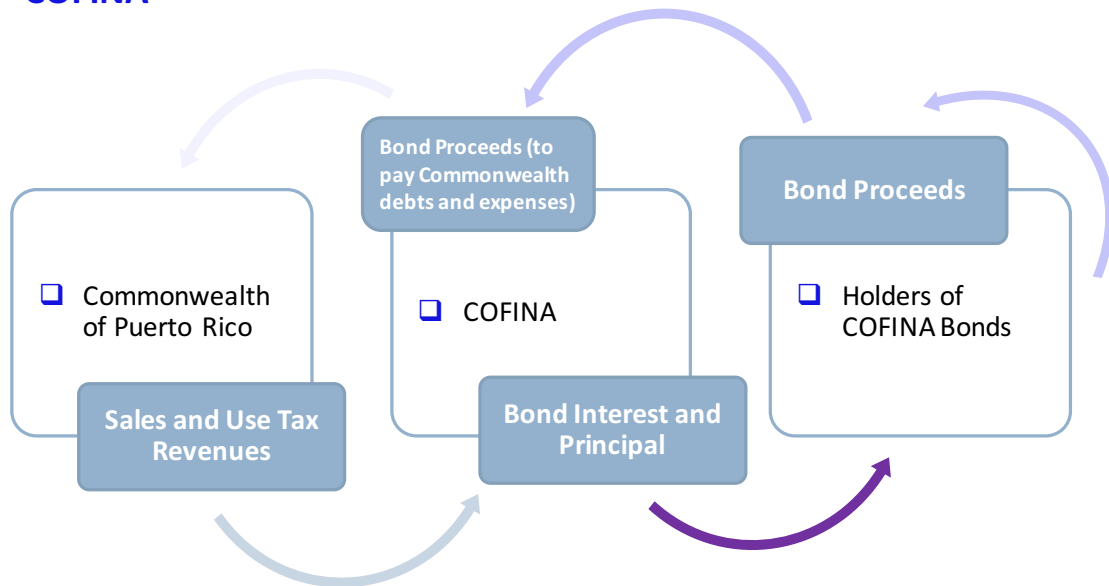
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Pre-Petition Relationship Between Commonwealth and the COFINA



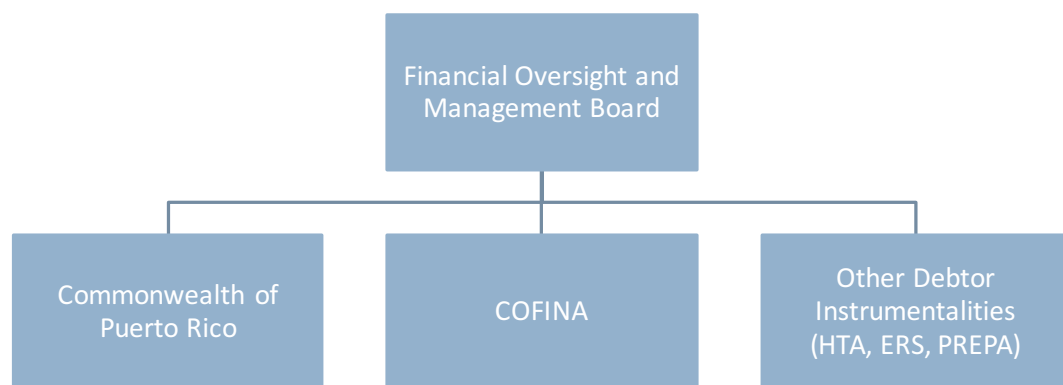
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PROMESA Title III Structure



“The Oversight Board in a case under [Title III of PROMESA] is the representative of the debtor.” 48 U.S.C. § 2175(b).

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Disputes Regarding COFINA Structure and Ownership of Pledged Sales and Use Tax

- ❑ In early May 2017, the Oversight Board, as representative of the Commonwealth and COFINA, filed petitions under Title III of PROMESA for each entity.
- ❑ Prior to the petition dates, certain Commonwealth creditors challenged the COFINA structure and the on-going receipt by COFINA of sales and use tax. Some creditors sought to continue that litigation post-petition.
- ❑ Certain creditors also argued in the Title III cases that the Oversight Board, as representative of entities on both sides of the dispute over the pledged sales and use tax, suffered from an inherent conflict and could not fairly resolve the issue itself.

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Stipulated Resolution of Procedure for Commonwealth-COFINA Dispute

- ❑ Ultimately, the key parties agreed to a stipulation to resolve these complex issues. Under the stipulation, for purposes of litigation concerning ownership of the pledged sales and use tax, independent agents were appointed for each entity:
 - The Official Committee of Unsecured Creditors of the Commonwealth and certain other instrumentalities (but not COFINA) was appointed as the “Commonwealth Agent”, and
 - Bettina Whyte was appointed as the “COFINA Agent.”
- ❑ In mid-2018, the independent agents reached an agreement in principle to resolve the so-called Commonwealth-COFINA Dispute.

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EFH Appendix

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Toys “R” Us Appendix

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