AMERICAN
BANKRUPTCY
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2018 Winter Leadership Conference

Current Issues Facing Unsecured Creditors' Committees

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ABI Winter Leadership Conference
December 7, 2018

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I. Introduction

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- 11 U.S.C. § 1102 – Governs the appointment of Creditors' Committees.
- 11 U.S.C. § 1103 – Governs the role of the Creditors' Committees.
  - (a) Professionals. Elect and authorize the employment of one or more attorneys, accountants, or other agents, to represent or perform services for such committee.
  - (b) Professional Conflicts. An **attorney or accountant** employed to represent a committee appointed under section 1102 **may not, while employed by such committee, represent any other entity having an adverse interest in connection with the case**. Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.
  - (c) A committee appointed under section 1102 **MAY**—
    - (1) **consult** with the trustee or debtor in possession concerning the administration of the case; (2) **investigate** the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor's business and the desirability of the continuance of such business, and any other matter relevant to the case or to the formulation of a plan; (3) **participate** in the formulation of a plan, advise those represented by such committee of such committee's determinations as to any plan formulated, and collect and file with the court acceptances or rejections of a plan; (4) **request** the appointment of a trustee or examiner under section 1104; and (5) **perform such other services as are in the interest of those represented.**
- The role of the Unsecured Creditors' Committee in a Chapter 11 case is to represent the interests of the entire class of unsecured creditors and to **maximize its recovery under a plan of reorganization**. *See, e.g.*, *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir. 2007); *In re Residential Capital, LLC*, 480 B.R. 550, 559 (Bankr. S.D.N.Y. 2012); *In re ABC Auto. Prods. Corp.*, 210 B.R. 437, 441 (Bankr. E.D. Pa. 1997).
- This presentation is intended to provide a general description of strategies employed by and common issues facing unsecured creditors' committees.

II. Committee's Role: Maximizing Value

II.A. Maximizing Value

- Committee's objective for maximizing value depends on the facts and circumstances of each specific case and must consider and evaluate numerous options.
  - Committee must consider whether an immediate liquidation or reorganization provides best chance of recovery.
  - Committee must decide whether to cooperate with the debtor or align with third parties (e.g. one or more secured creditors, potential acquirer) to increase value and distributions to constituency.
  - Committee must evaluate and, when appropriate, pursue litigation claims against insiders, current/former directors, and affiliates.
  - In terms of distributions, Committee must evaluate whether creditors are best served with lower lump sum distribution or higher distribution paid over time.
  - Committee also must consider whether receiver a distribution in cash or an equity participation in the debtor as a going concern.

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II.B. Shifting Trends for Official Committees of Unsecured Creditors

- Committees of unsecured creditors did not exist in their current form until the 1986 amendment to the Bankruptcy Code (i.e., appointed by the U.S Trustee rather than the bankruptcy court).
- At the time of the 1986 amendment, the primary focus was on reorganizing and rehabilitating distressed businesses, and committees of unsecured creditors were initially intended to serve as counterweight to debtor by overseeing debtor's activities in the case and serving as the debtor's primary negotiating counterparty in plan formulation process.
- Over time, Chapter 11 focus has shifted from true corporate reorganizations and rehabilitations in the bankruptcy process to the filing of prepackaged cases or pre-negotiated cases, plan sales and liquidations, and secured creditors' interests, each of which limits the activity of a Committee in the Chapter 11 case and desire of unsecured creditors to serve on a committee.
- In 2017, for public company Chapter 11 restructurings, half of the 10 largest and 23% of the year's total bankruptcies (17 of 71) utilized either a prepackaged or pre-negotiated restructuring, which was a 44% rise from 2016).
- Prepackaged and pre-negotiated filings result in limited time for formation of committees and active participation in Chapter 11 case and in certain cases eliminated the need for a committee (*see, e.g.*, *In re Global A&T Electronics Ltd.'s*, Case No. 17-23931 (Bankr. S.D.N.Y) (chapter 11 plan confirmed 5 days after filing), *In re Roust Corp.*, Case No. 16-23786 (chapter 11 plan confirmed 11 days after filing), and *In re Walter Inv. Mgmt. Corp.*, Case No. 17-13446 (Bankr. S.D.N.Y.) (chapter 11 plan confirmed 49 days after filing).

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II.B. Shifting Trends for Official Committees of Unsecured Creditors (*cont'd.*)

- Creditors becoming less interested in participating on committee because, *inter alia*, unwillingness to commit time and perceived or actual lack of say in restructuring process.
- Secured creditors now holding various tranches of debt and liens on virtually all of debtor's assets which results in control over cash collateral and post-petition financing dictating the Chapter 11 process – requiring milestone events, liquidation, and thereby limiting the bargaining power of committee because the unsecured creditors may be "out of the money."
- Steady uptick in the use of trade credit insurance, which limits unsecured creditor's desire and also opportunities to participate on committees, with certain UST offices requiring disclosure and disqualification of unsecured creditors with trade credit insurance from serving on a committee.
- Committees more frequently turning to the use of litigation and liquidating trusts to obtain recoveries for unsecured creditors.

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II.C. ABI Commission to Study the Reform of Chapter 11 – Committees of Unsecured Creditors in SME Cases

II.C.1. Definition of SME

- Small or medium business enterprise ("SME") means a business debtor with –
  - (i) No publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor's case; and
  - (ii) Less than $10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the petition date
- Additionally, if a business debtor satisfies subsection (i) above and has more than $10 million but less than $50 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates, the debtor may file a motion seeking to be treated as an SME in its chapter 11 case, such motion should be granted if Court determines SME treatment is in best interest of estate.

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II.C.2. Commission's Recommendation

- No appointment of an unsecured creditors' committee in an SME case unless an unsecured creditor or the U.S. Trustee files a motion with the court requesting the appointment and the court determines that the appointment is necessary to protect the interests of unsecured creditors in the case.
- If the debtor does not satisfy the Bankruptcy Code definition of SME but files a timely motion to be treated as an SME in the chapter 11 case, the U.S. Trustee should not appoint a committee of unsecured creditors unless the court denies the debtor's motion.
- If the debtor qualifies as an SME or is designated an SME by the court, the notice of the chapter 11 case served upon creditors should explain that the U.S. Trustee will not appoint a committee of unsecured creditors in the case unless such committee is requested by an unsecured creditor or the U.S. Trustee and the court orders such appointment. If the debtor indicates in its petition that it qualifies as an SME, such notice also should explain that parties in interest have 14 days from the date of such notice to object to the debtor's treatment as an SME.

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III. Typical Strategies Employed by Committees

III. Typical Strategies Employed by Committees

- **Rule 2004 Examinations**
  - (a) On motion of **any party in interest**, the court may order the examination of any entity.
  - (b) Scope – a Rule 2004 examination may relate only to the acts, conduct, or property or to the liabilities and financial condition of the debtor, **or to any matter which may affect the administration of the debtor's estate**, or to the debtor's right to a discharge. In a chapter 11 case, other than for the reorganization of a railroad, the examination may also relate to the operation of any business and the desirability of its continuance, the source of any money or property acquired or to be acquired by the debtor for purposes of consummating a plan and the consideration given or offered therefor, and **any other matter relevant to the case or to the formulation of a plan**.
  - (c) The court may compel attendance of an entity at a Rule 2004 examination as well as the production of documents.
  - The scope of a Rule 2004 Exam is broad and is frequently recognized as in the nature of a "fishing expedition."
  - Committees use Rule 2004 examinations to investigate, for example, (i) pre-petition transactions with insiders, affiliates, or management, (ii) preferential transfers, (iii) fraudulent transfers, (iv) breaches of fiduciary duty, and(v) potential claims against sponsors or secured creditors.

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III. Typical Strategies Employed by Committees (*cont'd.*)

- **DIP/Cash Collateral Challenges**
  - Adequate Protection
    - Seek to limit the scope of adequate protection.
  - Section 506(c) Waivers
    - Protect the estate's right to surcharge collateral.
  - Section 552
    - No waiver of the "equities of the case" exception with respect to whether a pre-petition lien continues as to post-petition proceeds and rents.
  - Marshaling Assets
    - Cause secured lenders to look first to certain encumbered assets before realizing on unencumbered assets.
  - Lien Challenges
    - Investigate validity/enforceability of pre-petition liens of secured lenders and determine whether liens were properly perfected.
  - Budget/timeline
    - Ensure there is an adequate budget and timeline for the Committee to investigate liens and claims.
  - Assess the economics regarding fees, rates, and milestones under DIP facilities; whether the DIP was properly shopped.
  - Seek to remove "automatic default" provisions in DIP if, for e.g., an RSA is terminated, or debtors or any party, file a motion to support an alternative plan.

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III. Typical Strategies Employed by Committees (*cont'd.*)

- **Assisting the Company with a Business Plan**
  - The Committee and its financial advisor often come into the case with a new perspective on the business plan. These new perspectives may include views on:
    - (i) what assets should be sold, (ii) SG&A savings, (iii) what if any businesses should be sold, (iv) strategic partners, (v) whether to have a rights offering, and (vi) whether the company can support exit financing.
  - The Committee should assess whether the Company's business plan is based on "real" numbers or if it has been adjusted downward in a potential effort to minimize value available to the entire capital structure and drive recovery towards a selected group of secured creditors.
- A related question is, how active should a Committee be in the development of a debtors' business plan, and what techniques can it use?
    - In *Toys "R" Us*, the Committee formed a subcommittee to meet with management and advisors to share market knowledge and examples of logistics efficiencies between vendors and the retailer.
    - The full benefit of any such collaboration will be limited by confidentiality concerns over certain commercial information.

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III. Typical Strategies Employed by Committees (*cont'd.*)

- **Management Incentive Programs (MIPs)**
  - The incentive programs/bonuses should be tied to certain metrics, such as EBITDA, important SG&A reductions, new contract wins.
  - The Committee should seek to ensure that management's interests are properly aligned with the general unsecured creditors ("GUCs") and that the metrics are tied to creditor recoveries so that MIPs are value accretive to the GUCs.
- **Preserving/waiving preferences**
  - Trade vendors may want to waive preferences so that vendors are not sued for pre-petition interactions.
  - But funded debt may want to preserve preference actions to pursue such claims.
  - These disparate interests should however, align where the Committee is recovering equity. In this instance, both funded debt and trade vendors should want to ensure preference actions are preserved.

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III. Typical Strategies Employed by Committees (*cont'd.*)

- **Ensuring adequate disclosure/communication with GUCs**
  - 11 U.S.C. § 1102(b)(3) requires that a creditors' committee appointed under section 1102(a) of the Bankruptcy Code "provide access to information for creditors who (i) hold claims of the kind represented by that committee; and (ii) are not appointed to the committee."
  - Much of the information Committees receive is confidential; thus, Committees commonly file an "1102 Motion," seeking clarification on its disclosure obligations under Section 1102(b)(3) and seeking authorization to implement protocols related to sharing this information.
  - A related question is, how proactive should a Committee be in informing the vendor community on status of the critical vendor program and the case overall?
    - The UCC websites are generally perfunctory. In some instances, e.g., the Committee may find it beneficial to beef up these websites. In *Toys "R" Us*, for example, the Committee spoke with trade associations and added content to the website on sales results, estimated claims levels, and FAQs on settlements .
    - In *Gibson Brands Inc.*, the Committee coordinated communications and reporting to vendors inquiring about their status as a critical vendor to make sure the program was implemented appropriately.

IV. Role of Committee Members and their Professionals

IV.A.1 Role of Committee Members

- The U.S. Bankruptcy Code does not provide much guidance as to the duties of committee members.
- The Committee, however, is universally considered a fiduciary for all general unsecured creditors. *See*, *e.g.*, *In re Dana Corp.*, 344 B.R. 35, 38 (Bankr. S.D.N.Y. 2006); *In re Pierce*, 237 B.R. 748, 758 (Bankr. E.D. Cal. 1999).
- Potential conflicts exist for members of the Committee between doing
  - What is best for the unsecured creditor class, and
  - What is in the member's best interests as an individual creditor.
- Absent a class of creditors recovering payment in full, a conflict naturally exists between every creditor within a class, as a reduction in any creditor's claim within the class provides a larger distribution to the remaining creditors.

IV.A.2 Examples of Potential Conflicts between Committee Members

- Unsecured Creditors' Committees are often made up of creditors with disparate interests. A committee member wears two hats: (1) promoting its own best interests; and (2) acting as a fiduciary for the class of unsecured creditors. In light of this, conflicts may arise, in for example, the following instances:
  - Claims at parent v. subsidiary
    - Valuation, allocation, litigation claims, intercompany claims.
  - Joint and several claims v. claims at a single debtor
    - Creditors may have claims at entities with lots of value but this could change if intercompany claims are pursued, e.g., one subsidiary may take value away from another.
  - Funded debt v. trade debt/PBGC
    - Creditors with an ongoing relationship with the debtors, e.g., trade may be more focused on ensuring the reorganized company emerges.
    - In contrast, funded debt creditors have an incentive to seek the most value from the debtors, including by pursuing litigation, such as Chapter 5 causes of action.
    - It can be challenging to balance unsecured creditors' focus on their percentage of recovery and trade creditors' interest in maintaining an ongoing relationship with the debtors (able to mitigate any percentage recovery losses through contract negotiations and future purchase orders).
  - Members participating in "New Money" transactions
    - "Pay to Play" scenarios – those not participating in the new money are harmed; but the debtors need the new money and the new funding is beneficial to the estate.

IV.B. Committee Professional Issues

- When filing a retention application, professionals are required to provide:
  - a statement of disinterestedness, and
    - the professional does not hold or represent an interest adverse to the Committee, debtors, or the estates
    - the professional is a "disinterested person" as defined by the Bankruptcy Code
    - the professional has no connection with the Committee, debtors, creditors, or any other party in interest, except as may be disclosed
  - disclosure of any potential conflicts.
- In *Choxi.com, Inc.*, Case No. 16-13131 (SCC) (Bankr. S.D.N.Y.), the financial advisor was retained as a joint advisor to the debtor and the Committee to perform all of the services set forth in its application.
- Judge Jones held that a banker was only allowed to be retained by the Unsecured Creditors' Committee if certain showings were made. *See In re Seadrill Ltd.*, Case No. 17-60079(Bankr. S.D. Tex.); *In re CJ Holding Co.*, No. 16-33590 (Bankr. S.D. Tex.); *In re Linn Energy, LLC*, Case No. 16-60040 (Bankr. S.D. Tex.).

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V. Issues Involving Independent Directors in Bankruptcy

V.A. Independent Director(s) Before Bankruptcy

- (a) Transactional
  - Appointed to negotiate transactions and evaluate their impact on the company where (a) a controlling shareholder is a party to the transaction, or (b) existing board members have a conflict of interest that renders them potentially unable to conduct good faith negotiations on behalf of the company.
- (b) Litigation
  - Appointed to conduct investigations into possible wrongdoing by the company or its directors and to provide recommendations as to whether a cause of action should be brought.
- (c) Benefits
  - Increases likelihood that the board's decisions will be shielded by the business judgment rule.
  - where the business judgment rule does not apply, shifts burden of proof to the plaintiff to prove lack of fairness.

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V.B. Independent Director(s) During Bankruptcy from the Debtor's Perspective

- (a) Purpose
  - (i) To provide additional experience in the restructuring/bankruptcy area
  - (ii) To evaluate and validate a ***future*** course of action in the eyes of stakeholders and the court, such as:
    - 1. A restructuring plan
    - 2. Sale transactions
    - 3. Incentive compensation for executives
  - (iii) To conduct investigations into and determine whether to bring claims based on ***past*** corporate conduct, such as:
    - 1. Potentially fraudulent transfers to insiders arising from leveraged buyouts, mergers, taking private transactions, or excessive executive compensation.
    - 2. Claims for breaches of fiduciary duty and/or fraud against officers and directors.
    - 3. Actions to recharacterize insider debt as equity and/or subordinate insider debt.

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V.B. Independent Director(s) During Bankruptcy from the Debtor's Perspective (*Cont'd.*)

- (b) Benefits
  - (i) With respect to **future** conduct, it increases likelihood that the court will:
    - 1. Approve the debtor's seemingly independent business judgment
    - 2. Leave existing management in place
  - (ii) With respect to **past** conduct, it:
    - 1. Avoids the appearance of a conflict of interest that would arise if the board of directors investigated its own conduct
    - 2. Reassures stakeholders (and the court) that the company is willing to honestly assess management's pre-bankruptcy conduct
    - 3. Strategically preempts the arguments for appointing a chapter 11 trustee or an examiner or for granting the creditors' committee standing to investigate and bring claims.

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V.C. Independent Director(s) During Bankruptcy From the Committee's Perspective

- (a) Usurps Committee's Role
  - (i) Bankruptcy Code already provides a means by which a truly independent body (and a real party in interest) can conduct investigations into pre-petition wrongdoing by granting standing to the committee to do so.
- (b) Perceived versus Authentic Independence
  - (i) Is the Independent Director really independent or is he or she merely rubber-stamping management's actions?
- (c) Scope of Independent Director's Role
  - (i) If the Independent Director's role is too limited (in scope or time), it is a sign that his or her appointment is merely cosmetic.
- (d) Cost
  - Independent directors may hire their own counsel and financial advisors. Adds layer of cost where creditors are already footing the bill for debtor's counsel, CRO, debtor's financial advisors and/or investment bankers and committee's professionals.

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V.D. Countermoves

- (a) Examine the scope of the Independent Director's duties.
  - (i) Is it clear that the Independent Director owes fiduciary duties to creditors
  - (ii) With respect to **future** conduct, is the Independent Director tasked with addressing all conflicts of interest that might arise in connection with the sale process, the plan process, post-petition executive compensation, debtor releases, intercompany negotiations and the settling inter-debtor claims and causes of action?
  - (iii) With respect to investigations into ***past*** conduct, is the Independent Director's investigation expansive? Does it include all potential claims against officers, directors, shareholders or other corporate insiders? Is it limited in time?
- (b) Examine the Independent Director's independence.
  - 1. Look at other cases in which the individual or their counsel have been appointed as an Independent Director to see how many times they have opposed management decisions with respect to future conduct or recommended bringing claims against insiders based on past conduct.

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V.D. Countermoves (*cont'd.*)

- (c) Move to terminate or suspend the Independent Director's investigation.
- (d) Oppose DIP financing (which may contain covenants related to the investigation that favor or require the Independent Director to investigate on a fast track).
- (e) Move for committee standing to investigate and pursue estate causes of action.
  - (i) Colorable claim
  - (ii) Benefit to the estate
  - (iii) Debtor unjustifiably refused to pursue the claim.
- (f) Oppose sale process.
  - (i)Of particular concern where shareholders may be bidding or management will be retained by stalking horse bidder.
- (g) Oppose restructuring plan or propose committee alternative.
- (h) Move for appointment of an examiner pursuant to Section 1104(c).

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V.E. Recent Cases Involving Independent Directors

- *In re Sears Holdings Corporation, et al.* (S.D.N.Y. Case No. 18-23538)
- *In re Mission Coal Company, LLC, et al.* (N.D. Ala. Case No. 18-04177)
- *In re iHeartMedia, Inc., et al.* (S.D. Tex. Case No. 18-31274)
- *In re Nine West Holdings Inc., et al.* (S.D.N.Y. Case No. 18-10974)
- *In re VER Technologies Holdco LLC, et al.* (D. Del. Case No. 18-10834)
- *In re BCBG Max Azria Global Holdings, LLC, et. al.* (S.D.N.Y. Case No. 17-10466)
- *In re Gymboree Corporation, et al.* (E.D. Va. Case No. 17-32986)
- *In re Payless Holdings LLC, et al.* (E.D. Mo. Case No. 17-42267)
- *In re Seadrill Ltd., et al.* (S.D. Tex. Case No. 17-60079)
- *In re Toys "R" Us, Inc., et al.* (E.D. Va. Case No. 17-34665)
- *In re Linn Energy, LLC, et al.* (S.D. Tex. Case No. 16-60040)
- *In re Southcross Holdings, LP, et al.* (S.D. Tex. Case No. 16-20111)
- *In re Caesars Entertainment Operating Company, Inc., et al.* (N.D. Ill. Case No. 15-01145)
- *In re Samson Resources Corporation, et al.* (D. Del. Case No. 15-11934)
- *In re Residential Capital, LLC, et al.* (S.D.N.Y. Case No. 12-12020)

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VI. Rights Offerings

VI.A. Rights Offerings

- A rights offering is a form of exit financing that allows a debtor to offer creditors or equity security holders the right to purchase equity, at a set subscription price, often at a discount, during a set subscription period, in the reorganized debtor post-emergence.
- **Components**:
  - Backstop Fee – one or more parties commit to subscribe for a minimum amount and in return, receive a commitment/backstop fee and other consideration (e.g., break-up fee, expense reimbursement, indemnifications).
  - Participation – eligible participants are often limited to a pool of creditors.
    - Often limits who may participate and how much non-backstop parties are able to purchase
  - Price – typically the securities may be purchased at a discount to plan equity value.
    - While a large discount attracts interest, it also increases the dilutive effect of the issuance on those not participating.
- The Committee should consider: (i) whether the backstop subject to a market test; and (ii) whether modifications can be made to a proposed rights offering that would benefit non-participating unsecured creditors.
- Potential Issues: (i) certain creditors may not be permitted to participate; (ii) unequal treatment among class members; (iii) sub rosa plan, e.g., locking up votes of those who participate in the rights offering prior to solicitation; and (iv) whether the rights offering enhancing recoveries for unsecured creditors.

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VI.B. *In re Pacific Drilling S.A.* (Bankr. S.D.N.Y. Case No. 17-13193)

- $460 million capital raise comprised of:
  - $460 million of new equity, offered at a 46.9% discount to Plan value
- The Backstop Parties would receive the following fees:
  - Commitment Fee: 8.0% of the uncommitted portions of the equity offering, payable in equity in Reorganized Pacific Drilling.
  - Backstop Put Premium: 5.0% of the committed portions of the equity offering, payable in equity in Reorganized Pacific Drilling.
- Initially, the Debtors proposed a $400 million rights offering open only to three classes of creditors, and an additional $100 million private placement to the Ad Hoc Group. The Ad Hoc Group was also to receive an 8% backstop fee in reorganized equity.
- Quantum Pacific proposed a competing rights offering, comprised of a $400 million rights offering any creditor could participate in, a 7% backstop fee, and a $100 million private placement for Quantum Pacific (as a lower discount to Plan value).

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VI.B. *In re Pacific Drilling S.A.* (Bankr. S.D.N.Y. Case No. 17-13193) (*cont'd.*)

- The Debtors sought filed a motion seeking court approval of their equity rights offering and the Equity Commitment Agreement (the "Motion"), and 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.
  - In ordering the parties to mediation, Judge Wiles noted that:
    - The private placement for the ad hoc group was not equitable.
      - » Following mediation, the parties agreed to eliminate the private placement.
    - The backstop fee was not reasonable, given that it was being paid in stock at a high discount to Plan value.
      - » Following mediation, the parties agreed that the fee on committed portions of the equity offering would be reduced to 5%.
- 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.

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VI.B. *In re Pacific Drilling S.A.* (Bankr. S.D.N.Y. Case No. 17-13193) (*cont'd.*)

- Judge Wiles approved the Motion, noting that no creditor had objected to the Backstop Fee, but despite the consensual nature of the relief sought, noted that:
  - "**The theory of the Bankruptcy Code is that when the big creditors sit in a room and negotiate a deal, the little creditors who are in the same boat get the same deal.** The Bankruptcy Code does not permit the unequal treatment of creditors in the same class; it also does not permit the payment of extra compensation to large creditors in exchange for their commitment to vote for a plan. **The problem with special allocations in rights offerings, or with private placements that are limited to the bigger creditors who sat at the negotiating table, or big backstop fees that are paid to the bigger creditors who sat at the negotiating table but that are not even open to other creditors (and in particular to other creditors in the same class), is that it is far too easy for the people who sit at the negotiating table to use those tools primarily to take for themselves a bigger recovery than smaller creditors in the same classes will get.** The Code allows for reasonable financing terms but they must be reasonable, and **they cannot just be a disguised means of giving bigger creditors a preferential recovery.** I therefore made clear that to the extent that these terms were being represented to me as reasonable financing terms, the parties would need to convince me that the terms were reasonable as a financing matter and were better than other options."[1]

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

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VI.B. *In re Pacific Drilling S.A.* (Bankr. S.D.N.Y. Case No. 17-13193) (*cont'd.*)

- Judge Wiles continued:
  - "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*, Case No. 17-13193, at 10.

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VII. Trends in Prepackaged and Pre-negotiated Cases

VII. Prepackaged/Pre-negotiated Case Trends
General Findings: Pre-Filings[1] Account for a Majority of Reorg Emergence

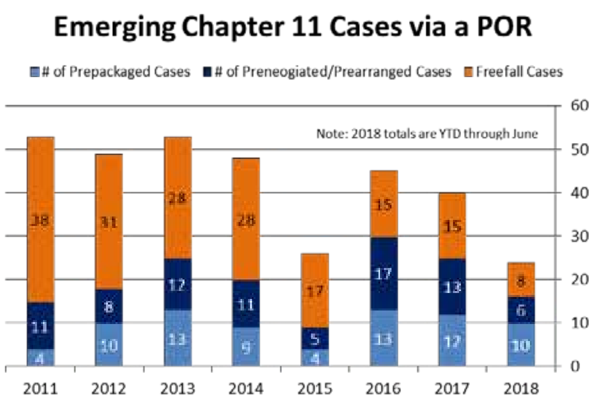
We compiled 434 Chapter 11 case filings[2] that emerged via a plan of reorganization between 2010 and 1H2018, then summarized and evaluated notable characteristics of these filings.

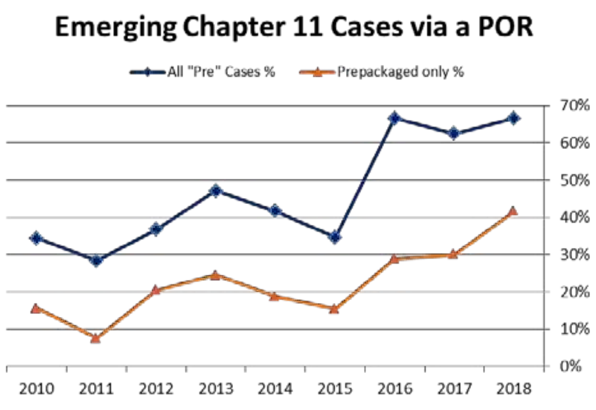
- 191 of 434 filings—or 44%—that emerged in these eight years were Pre-filings
  - However, that percentage jumped to 65% in 2016-2018 vs. 37% in 2010-2015.
  - Prepackaged filings consistently accounted for approximately one-half of all Pre-filings.
- Consequently, average case length decreased to 212 days in 2016-2018 from 400 days in 2010-2015 as a result of the larger proportion of Pre-filing cases as well as a notable decrease in average case length for freefall filings after 2015.
- Private equity-owned companies are more likely to be a Pre-filing than non-sponsored companies, with 63% of sponsor-owned filings being a Pre-filing vs. 37% for non-sponsored filings.
- Large debtors (>$1B in liabilities at filing) were more likely to be a Pre-Filing than smaller debtors (<$1B), with 58% of large filings being Pre-filings vs. 38% for smaller filings.
- Energy and media sectors had more relative Pre-filings than other industry sectors.
- Filings in Delaware accounted for an outsized share of Pre-filings.
  - Delaware accounted for 42% of all filings but 54% of all Pre-filings.
  - Filings outside Delaware, SDNY and SDTX accounted for 35% of all filings but only 16% of all Pre-filings.

[1] Pre-Filings refer to either a prepackaged filing or a pre-negotiated/prearranged filing
[2] Liabilities at filing > $50 million and a case resolution that did not result in a sale of the debtor or substantially all its assets.

VII. Prepackaged/Pre-negotiated Case Trends (*cont'd.*)
As the Proportion of Prepackaged/Pre-negotiated Cases Increases…

- Pre-filings accounted for 44% of filings from 2010-2018
  - However, 65% were Pre-filings from 2016-2018 vs. 37% from 2010-2015.

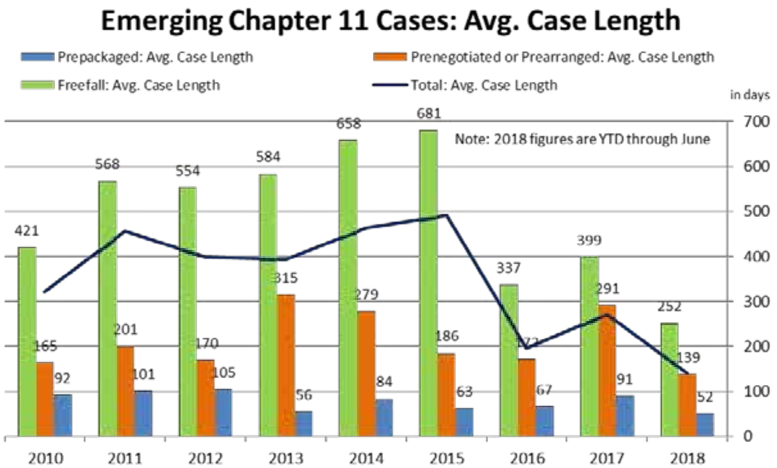




Source: The Deal Pipeline and FTI Consulting
Note: Pre-Filings refer to either a prepackaged filing or a pre-negotiated/prearranged filing.
Only includes cases with liabilities at filing > $50 million and a case resolution that did not result in a sale of the debtor or substantially all its assets.

VII. Prepackaged/Pre-negotiated Case Trends (*cont'd.*)
…Average Case Length of Reorganizations Has Decreased

- Average case length for prepackaged and pre-negotiated filings has remained fairly steady at 80 days and 210 days, respectively, but these Pre-filings have accounted for a larger proportion of total filings in recent years.
- Moreover, average case length for freefall filings has declined to 345 days since 2016 from 545 days in 2010-2015.



Source: The Deal Pipeline and FTI Consulting
Note: Pre-Filings refer to either a prepackaged filing or a pre-negotiated/prearranged filing.
Only includes cases with liabilities at filing > $50 million and a case resolution that did not result in a sale of the debtor or substantially all its assets.

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VII. Prepackaged/Pre-negotiated Case Trends (*cont'd.*)
Pros and Cons of Prepackaged/Pre-negotiated Filings

Pros of Pre-Filings

- Most expedient way to effect a reorganization when an out-of-court workout is not possible.
- Most appropriate when a deleveraging transaction is the primary or sole objective.
- Significant buy-in from major creditor groups reduces implementation risk and improves likelihood of timely case resolution.
  - A Pre-filing projects a process that is under control and less likely to "go off the rails" given the extensive negotiations, planning and preparation involved.
- Significantly shorter case lengths than a freefall filing—often from one-third to one-half the case duration of a typical freefall.
- Fewer bankruptcy-related expenses preserves liquidity for the debtor.

Cons of Pre-Filings

- A Pre-filing plan could run the risk of improper solicitation of creditors or failure to meet adequate information requirements as per Sections 1125 and 1126 of the Code.
- Parties not included in the negotiation of a Pre-filing might feel alienated, and behave accordingly, as a result of their exclusion.
- The RSA of a Pre-negotiated filing can still be contentious and potentially unravel.
  - RSAs of Caesars Entertainment and Claire's Stores both encountered stiff resistance from holdout creditors and were renegotiated to improve recoveries to holdout groups.
- Operational fixes of the debtor often not a high priority in a Pre-filing case.
  - Competitive disadvantages of a debtor more likely to remain unresolved.

Note: Pre-Filings refer to either a prepackaged filing or a pre-negotiated/prearranged filing.

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VII. Prepackaged/Pre-negotiated Case Trends (*cont'd.*)
GUC Recoveries in Pre-negotiated Filings Often Can Be Improved

Some notable cases involving a pre-negotiated filing produced outcomes with improved recoveries for GUCs compared to the RSA's original terms.

Caesars Entertainment Operating Co:

- RSA on the petition date had an estimated recovery percentage of 8% for GUCS, while the final recovery rate to GUCS, including unsecured bonds, per the POR—some two years after the filing—was 66% via a combination of cash, new convertible notes and preferred equity. Despite having an RSA going into the filing with large support from first lien creditors, it was a most contentious case throughout its pendency.

Energy XXI Ltd.:

- RSA filed on first day had unsecured bonds receiving out-of-the-money warrants to purchase up to 10% of the new equity. Recovery percentage was not described, but was likely less than 1%. Recovery to GUCs was shown as TBD.
- POR had certain unsecured noteholders receiving pro rata share of 16% of the equity in the reorganized debtor, in addition to warrants to purchase 6% of the equity—an estimated recovery range of 7– 13%, trade claims received an estimated 90% recovery, while other general unsecured creditors received a pro rata share of $1.45M (estimated 10% recovery).

Seadrill Limited:

- RSA had an estimated recovery percentage of 18.4% for Class D3 GUCS and 25.8% for Class B3 GUCS.
- After protracted negotiations with the debtor and related parties, the final recovery rate per the POR for Class D3 GUCs and Class B3 GUCs increased to 27.2% and 38.8%, respectively.

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VII. Prepackaged/Pre-negotiated Case Trends (*cont'd.*)
Some Notable Pre-Filings Didn't Have UCCs at All

Some large filings in 1H 2018 were prepacks that fully paid General Unsecured Creditors, leaving them unimpaired in order to expedite the reorganization. Consequently, no UCCs were formed in these cases—not an encouraging development for unsecured creditor-side advisors.

Debtor	Filing Date	Emerge Date	Liabilities at Filing (in millions)	Case Length in Days	Venue	Filing Type
New MACH Gen LLC	6/11/2018	9/6/2018	$710	87	Delaware (18-11368)	Prepackaged
HCR ManorCare	3/4/2018	7/26/2018	$7,118	144	Delaware (18-10467)	Prepackaged
Southeastern Grocers LLC (Bi-Lo)	3/27/2018	5/31/2018	$2,625	65	Delaware (18-10700)	Prepackaged
Remington Outdoor Co.	3/25/2018	5/15/2018	$954	51	Delaware (10-10684)	Prepackaged
Fieldwood Energy LLC	2/15/2018	4/11/2018	$1,000+	55	Texas Southern (18-30648)	Prepackaged
Harvey Gulf International Marine	3/7/2018	7/2/2018	$1,000+	117	Texas Southern (18-31080)	Prepackaged
Rand Logistics	1/29/18	3/1/2018	$259	31	Delaware (18-10175)	Prepackaged

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Questions?